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Supreme Court, U.S.
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No.

In the

# Supreme Court of the United States

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DAVID I. LONGMAN; JEFFREY FEINMAN; PAUL M. GARDNER, Defined Plan Trust; EDWARD HANKIN and LINDA HANKIN,

*Petitioners,*

*versus*

FOOD LION, INCORPORATED; TOM E. SMITH,

*Respondents.*

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*On Petition for Writ of Certiorari to the United States Court of Appeals for the ~~Third~~ 4th Circuit*

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## PETITION FOR CERTIORARI

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## QUESTION PRESENTED

Whether, in a securities fraud action, a public statement is sufficient, as a matter of law, to rebut the "fraud on the market" presumption established by this Court regardless of the credibility of the statement's source.

## TABLE OF CONTENTS


| | PAGE |
|---|---|
| Questions Presented | i |
| Table of Contents | ii |
| Table of Authorities | iv |
| Opinions Below | 1 |
| Jurisdictional Statement | 1 |
| Relevant Constitutional Provisions, Treaties, Statutes, Ordinances, and Regulations Involved | 1 |
| Statement of the Case | 3 |
| Proceedings Below | 4 |
| Statement of Facts | 5 |

Reasons for Granting the Writ ..... 15

THE COURT BELOW ERRED IN RULING THAT THE PRESUMPTION THAT PETITIONERS RELIED ON RESPONDENTS' MISREPRESENTATIONS WAS DEFEATED BY THE EXISTENCE OF PUBLIC STATEMENTS CONTRADICTING THE MISREPRESENTATIONS, NOTWITHSTANDING THE OVERWHELMING EVIDENCE THAT THE MARKET DID NOT CONSIDER THE SOURCE OF THE CONTRADICTORY STATEMENTS TO BE CREDIBLE. ..... 17

Conclusion ..... 24

Appendix

Decision of the Circuit Court (App A) ... 1a

Decision of the District Court of 1/4/99 (App B) ..... 29a

Decision of the District Court of 6/18/98 (App C) ..... 54a

Order Denying Rehearing (App D) ..... 119a

## TABLE OF AUTHORITIES


| CASES: | PAGE |
|---|---|
| *Associated Randall Bank v. Griffin*, 3 F.3d 208, 213-14 (7th Cir. 1993). | 19 |
| *Basic Inc. v. Levinson*, 485 U.S. 224, 238 (1988), | 17, 19, 23 |
| *Berry v. Valence Tech., Inc.*, 175 F.3d 699, 706 (9th Cir. 1999) | 22 |
| *Braxton v. United States*, 500 U.S. 344 (1991). | 16 |
| *Ernst & Ernst v. Hochfelder*, 425 U.S. 195, 196 (1976) | 17 |
| *Finkel v. Docutel/Olivetti Corp.*, 817 F.2d 356, 360 (5th Cir. 1987) | 23 |
| *Gasner v. Board of Supervisors*, 103 F.3d 351, 356 (4th Cir. 1996). | 17 |
| *Grossman v. Novell, Inc.*, 120 F.3d 1112, 1122 (10th Cir. 1997) | 22 |
| *Heflin v. United States*, 358 U.S. 415 (1959) | 16 |

*In re Taxable Mun. Bonds Litig.*, [1994-1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,405 at 90,780 (E.D. La. Sept. 26, 1994) ..... 22

*Kaplan v. Rose*, 49 F.3d 1363, 1376 (9th Cir. 1994) ..... 22

*Longman v. Food Lion, Inc.*, 197 F.3d 675 (4th Cir. 1999) ..... 1

*Ockerman v. May Zima & Co.*, 27 F.3d 1151, 1158 (6th Cir. 1994) ..... 23

*Provenz v. Miller*, 102 F.3d 1478, 1492 (9th Cir. 1996), *cert. denied*, 188 S. Ct. 48 (1997); 19, 21

*Pure Oil Co. v. Suarez*, 384 U.S. 202 (1966); . 16

*Sailors v. Northern States Power Co.*, 4 F.3d 610, 613 (8th Cir. 1993) ..... 21

*Schneider v. Vennard (In re Apple Computer Sec. Litig.)*, 886 F.2d 1109 (1989), *cert. denied*, 496 U.S. 943 (1990). ..... 19

*Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1214 n.25 (1st Cir. 1996) ..... 21

*TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438 (1976). ..... 21

*Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 516 (7th Cir. 1989) ..... 21

COURT RULES:

F.R.C.P. Rule 12(b)(6) ..... 21

Sup. Ct. R. 10(c); ..... 16

REGULATIONS:

17 C.F.R. 240.10b-5 ..... *passim*

STATUTES:

15 U.S.C. § 78j(b) ..... 1

28 U.S.C. § 1254(1). ..... 1

OTHER AUTHORITIES:

John M. Newman, Jr., et al., *Basic Truths: The Implications of the Fraud-On-The-Market Theory for Evaluating the "Misleading" and "Materiality" Elements of Securities Fraud Claims*, 20 J. Corp. L. 571, 576 (1995) ..... 22

*The Fraud-on-the-Market Theory*, 95 Harv. L. Rev. 1143, 1159 (1982) ..... 23

Petitioners, David I. Longman, Jeffrey Feinman, Paul N. Gardner Defined Plan Trust, Edwin Hankin, and Linda Hankin, and a class of similarly situated persons, respectfully request that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the Fourth Circuit in this case.

## OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fourth Circuit is reported at *Longman v. Food Lion, Inc.*, 197 F.3d 675 (4th Cir. 1999) at App A). The opinion of the district court in *Longman v. Food Lion, Inc.*, Nos. 4:92CV696 and 4:92CV705 (M.D.N.C. June 18, 1998) (App. C), is not published.

## STATEMENT OF JURISDICTION

The judgment of the United States Court of Appeals for the Fourth Circuit was entered on October 7, 1999. The Fourth Circuit denied a timely petition for rehearing on November 5, 1999. (App. D).

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

## CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

15 U.S.C. § 78j(b) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of

the mails, or of any facility of any national securities exchange—

* * *

> (b)To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

17 C.F.R. 240.10b-5 provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> > (a)To employ any device, scheme, or artifice to defraud,
> >
> > (b)To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under

> which they were made, not misleading, or
>
> (c)To engage in any act, practice, or course of business which operates or would operate as a fraud of deceit upon any person, in connection with the purchase or sale of any security.

## STATEMENT OF THE CASE

This case involves the "fraud on the market" presumption established by this Court to relieve a plaintiff in a securities fraud action of the burden of proving his actual reliance upon a corporation's public misrepresentations. The fundamental question presented in this petition is whether the fraud on the market presumption may be rebutted, as a matter of law, by a public statement contradicting the corporation's misrepresentations *without regard to the credibility of the public statement's source.*

Under the analysis of the court below, such a public statement, even from the least reputable source, will conclusively operate to defeat the presumption—even, as here, in the face of overwhelming evidence that the market completely disregarded the statement. Moreover, once such a statement is made, whatever its source, the appellate court's ruling permits the corporation to re-publicize its outright false statements with impunity—again, exactly the situation in this case. The Fourth Circuit's ruling, if it is allowed to stand, promises effectively to eliminate the fraud on the market presumption in that jurisdiction.

**Proceedings Below**

Petitioner Longman filed his class action complaint on November 12, 1992. Petitioners Feinman, Paul N. Gardner Defined Trust Plan, and Hankins filed a similar class action on November 13, 1992. Both the *Longman* and *Feinman* complaints alleged, *inter alia*, causes of action for securities fraud under § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. The gravamen of petitioners' complaints, for purposes relevant here, is that respondent Food Lion, Inc. ("Food Lion"), a grocery store chain, and its president, respondent Tom E. Smith, failed to disclose, and expressly denied, widespread illegal labor practices that artificially inflated its earnings and margins and, in turn, the value of its stock.

The district court consolidated the cases on March 16, 1994. On October 17, 1994, the court certified the cases as a class action for open market purchasers of Food Lion stock between May 7, 1990 and November 5, 1992 (the "Class Period").

On June 18, 1998, the United States District Court for the Middle District of North Carolina, per Judge James A. Beaty, granted respondents' motion for summary judgment and dismissed the action. The district court ruled that Food Lion's illegal labor practices were fully disclosed to the public on September 11, 1991—the date of an announcement by the United Food and Commercial Workers Union (UFCW) that it had filed a complaint against Food Lion with the United States Department of Labor (DOL). As a result of such "full disclosure to the market," the district court

determined that investors who purchased Food Lion stock *after* that date did not justifiably rely on Food Lion's allegedly material omissions. Investors who purchased *before* the "full disclosure" date of September 11, 1991, the court ruled, were barred by limitations since their actions were filed more than one year after that date. (App ).

On October 7, 1999, a divided panel of the Fourth Circuit affirmed. The majority concluded that respondents' false and misleading statements were not material as a matter of law, since the UFCW had announced, during the Class Period, that it was filing a complaint with DOL requesting that DOL file a Fair Labor Standard Act (FLSA) class action against Food Lion:

> Plaintiffs' securities fraud claim cannot succeed because, despite the fact that Food Lion denied the charges, the nature of the off-the-clock claims and the claims' risk to earnings were in fact well known to the market before the [end of the Class Period], and therefore Food Lion's omissions were not material. . . . The market had a full opportunity to evaluate these claims and to reflect their risk in the market price for Food Lion stock.

(App. A).

Judge Murnaghan, in dissent, wrote:

> The majority incorrectly suggest that *any* public information contradicting Food Lion's misleading statements forecloses the possibility of finding that these statements were material. However, the controlling principle is that in a fraud on the market case, Food Lion's failure to disclose material information may be excused where that information has been made *credibly available* to the market by other sources. . . . The majority does not analyze whether the allegations against Food Lion came from a *credible* source.

(App. A) (emphasis in original; citations, footnoteomitted).

The Fourth Circuit denied petitioners' petition for rehearing and rehearing en banc on November 5, 1999. (App. D).

**Statement of Facts**

Throughout the Class Period, Food Lion failed to disclose, and expressly denied, the illegal labor practices that artificially inflated its earnings and profit margins, and in turn, the value of its stock. Petitioners purchased Food Lion stock during the Class Period in reliance on the integrity of the price set by the market. However, upon the public disclosure of Food Lion's illegal practices in a November 5, 1992 broadcast of the ABC news program *PrimeTime Live* (*PTL*), and an announcement by DOL on November 7, 1992, that it would file a FLSA class action against Food Lion, the

market corrected the price of Food Lion's common stock, much to petitioners' detriment.

Petitioners adduced extensive evidence that Food Lion's oppressive labor policies resulted in widespread illegal labor practices, and that Food Lion's management was aware of such widespread violations during the Class Period. Food Lion had in place a time-management quota system called "Effective Scheduling," which required employees to perform certain duties within specified times. If the employee failed to complete the tasks within the allotted time, he or she was faced with two choices: (1) be fired or (2) finish the work "off the clock."

Food Lion's top management was well aware that its effective scheduling labor practice inevitably resulted in employees working off the clock. The overwhelming evidence of the existence of, and Food Lion's knowledge of, widespread labor law violations includes (1) a report to top Food Lion officials prepared by a Food Lion lawyer who had been directed to investigate off-the-clock work at Food Lion, concluding that Food Lion's labor policies would unavoidably result in off-the-clock work throughout the Food Lion system; (2) internal survey responses, circulated to top Food Lion executives, from employees of more than 30 Food Lion stores complaining of oppressive working conditions in which employees frequently worked from 10 to 40 hours per week off-the-clock in order to perform all the duties required of them; (3) internal investigative reports, copied to top Food Lion executives, detailing rampant federal labor law violations throughout the Food Lion system; and (4) numerous internal memoranda, circulated among

management officials, discussing reports of widespread illegal labor practices.

Despite this overwhelming evidence of internal corporate knowledge of widespread illegal labor practices, Food Lion continually and vociferously denied any knowledge of such practices throughout the Class Period. There is no question that Food Lion published during the Class Period several false and misleading statements about its labor practices and policies—and the Fourth Circuit did not hold otherwise. Indeed, the evidence that Food Lion made numerous false public statements about its illegal labor practices is undisputed.

For example, on May 7, 1990—the first day of the Class Period—Food Lion filed with the Securities and Exchange Commission its Annual Report to Stockholders for the year ending December 31, 1989. The report boasted about decreased selling and administrative costs, as well as "improved operating efficiencies," but in no way suggested that Food Lion had discounted its labor costs by means of illegal practices. The document referred to Food Lion's labor practices in glowing terms, alluding to "expand[ed] financial rewards for employees," as well as the company's commitment to "insur[ing] that Food Lion employees receive competitive wages and excellent benefits."

Food Lion, on August 30, 1990, issued a press release in response to calls by the UFCW for a boycott of Food Lion stores. The press release falsely portrayed Food Lion employees as well-compensated persons working in positions that were highly sought after by the work force, as follows:

> The fact is, Food Lion opens more than 100 stores each year and adds more than 5,000 employees each year. *Food Lion could not do this without offering competitive wages and excellent benefits.* On average, Food Lion receives three to four applications for every available job.

(Emphasis added).

In a September 11, 1991 press release, the UFCW disclosed that it had filed a complaint with the DOL requesting that the government bring a class action suit against Food Lion. The UFCW press release described its complaint before the DOL as alleging that Food Lion had derived about 37% of its after-tax profit from illegal work. The press release further disclosed that the union's complaint asked the DOL to seek an injunction requiring Food Lion to desist from further use of its Effective Scheduling System, Food Lion's time-management quota system.

Food Lion, on the same date, publicly denied the UFCW's allegations and impugned the UFCW's motives. Food Lion's September 11, 1991 press release asserted that it had a "very clear policy against working off the clock," and cautioned that "[i]t should be kept in mind that this same union was previously involved in another Fair Labor Standards Act (FLSA) Complaint in which it was discovered many of the allegations were totally without merit." The press release did not mention that Food Lion had entered into two secret compliance agreements with the DOL and had

paid substantial fines as a result of illegal labor practices in the previous three years.[1]

The next day, Food Lion issued an even stronger denial of the union's claims. Food Lion's September 12, 1991 press release included the following passages:

> The UFCW's most recent claims of illegal employment practices by Food Lion and its employees insult the hard work and integrity of all Food Lion employees. Those ingredients are the key to Food Lion's success and ability to bring customers extra low prices. *It is not off the clock work by employees or other illegal employment practices as the UFCW-sponsored propaganda alleges.* . . . [O]ur employees' hard work and company efficiencies in

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[1] Before the Class Period, Food Lion had been the target of investigations and disciplinary actions for its illegal labor practices; however, the punitive measures resulting from the earlier investigations were kept in strict confidence. Three years before the *PTL* broadcast, Food Lion entered into a compliance agreement with the DOL and consented to pay $300,000.00 in wages related to off-the-clock work. This 1989 settlement agreement, however, was confidential and was not disclosed even to most Food Lion employees. After a second DOL investigation, Food Lion, on October 11, 1990, entered into another compliance agreement and further agreed to pay all back wages earned by participants in a sham "training" program. The terms of this 1990 settlement were not disclosed to the investing public or even to most Food Lion employees. In both compliance agreements, Food Lion explicitly agreed to assume accountability for monitoring and enforcing the company's compliance with the FLSA.

operations result in lower prices which threaten unionized competitors.

- *Food Lion denies the claims of employee mistreatment*, but the public doesn't have to accept the word of either the Company or the union. Let employees and the free marketplace decide that. If employees don't want to work at Food Lion, they don't have to. The fact that Food Lion receives four or five job applicants for every job opening and consistently has one of the lowest employee turnover rates in the supermarket industry, should tell you more about the UFCW's propaganda than anything Food Lion says. This same union was involved two years ago in another FLSA "class action" lawsuit against the company. Upon investigation of the UFCW-instigated claims, however, it was discovered most of the allegations were totally without merit and at least one of the complainants had never even worked for Food Lion. . . .

Such results from previous lawsuits by this same union against Food Lion make it all the more important to recognize that this latest Complaint is simply a charge filed with the Department of Labor by a labor union which is trying to destroy Food Lion and its employees' jobs.

(Emphasis added).

A week later, on September 19, 1991, Food Lion's Class A stock was trading at $18.25, *up* from the $17.00 price after the UFCW's announcement. UFCW's announcement that it had filed a complaint with the DOL did not negatively impact the price of Food Lion's stock, for a variety of reasons. First, as conceded by Food Lion's own expert, the reports of the company's labor violations before and during the Class Period were not "widely reported." More importantly, due to Food Lion's efforts to discredit the UFCW's claims, combined with the lack of any public statement by the DOL on Food Lion's labor practices during the Class Period, leading market analysts discounted the UFCW's claims as mere "harassment," and even suggested that it was a good time to buy Food Lion stock. For example, Robinson-Humphrey's October 8, 1991 company report on Food Lion recites:

> In this latest move, the union filed a complaint with [DOL] claiming that a significant portion of Food Lion's profits are derived from illegal off-the-clock work of employees. . . . Bottom line, we have yet to see a complaint from this union which accurately documents illegal practices and believe that this latest action is a form of harassment.

The Robinson-Humphrey report recommended purchasing Food Lion stock.

Paine Webber's November 21, 1991 Report on Food Lion stated:

> The [UFCW] has named Food Lion as a top priority target for unionization and toward this end has essayed a variety of pressure tactics over the years. Yet the union has neither gotten to first base with employees nor disrupted business.

Likewise, Goldman Sachs' October 2, 1991 Research Brief on Food Lion discounted the validity of the UFCW's claims:

> We regard this complaint as another attempt by the union to establish collective bargaining agreements at Food Lion. . . . [W]e note that the same union has brought allegations in the past, which have been largely unsubstantiated.

*See also* Decl. of Lee Wilder dated 1/24/96 (stock analyst states that he "discounted the merit of the UFCW's charges" in light of Food Lion's insistence that the union's allegations were groundless). In contrast, respondents have come forward with no evidence that *any* brokerage firm or stock analyst was influenced in his analysis of Food Lion's stock by the union's claims.

Even Food Lion's own expert economist, Frederick C. Dunbar, conceded at deposition that Food Lion's denials of FLSA violations affected the total mix of information available to the market:

> I think that if Food Lion had issued absolutely no press release and had been silent, there may have been a different result. If Food Lion admitted the charges, which Food Lion never did, it's hard to say what would have happened to the stock price.

On February 27, 1992, in response to UFCW's announcement that the union had filed a supplemental complaint with the DOL alleging additional new claims, Food Lion issued yet another press release expressly denying the claims: "UFCW sponsored claims of extensive wage/hour violations are simply untrue. . . . Food Lion denies this and other UFCW sponsored allegations of mistreatment of employees."

Food Lion's offenses were first disclosed to the public in credible fashion on November 5, 1992—the last day of the Class Period—when the ABC news program *PrimeTime Live* presented an exposé on Food Lion's labor and sanitation practices. The *PTL* broadcast was the result of six months of investigation by ABC. The *PTL* team interviewed 70 then-current and former employees at stores across the southeastern United States. In addition to undercover footage of repugnant sanitary practices which were the inevitable result of Food Lion's brutal scheduling system, Diane Sawyer, the narrator of the broadcast, reported as follows:

> Over and over again, we were told that for workers, Food Lion is a kind of pressure cooker. The employees all said that the

> company pays good salaries and has excellent benefits, including profit sharing. But there's a flip side, a time-management policy called effective scheduling, which critics charge forces a lot of workers to finish the work on their own time . . . .
>
> Many employees told us that the pace [required by Effective Scheduling] is pounding. And since very little overtime is permitted, at the end of the day good workers were faced with an impossible choice: leave work unfinished jeopardizing their jobs, or stay and finish, giving extra hours to the company without pay. It's called working off-the-clock, and it's illegal.

The day after the *PTL* broadcast, the price of Food Lion's stock plunged. The company's Class A stock fell from $9¼ per share to as low as $6 1/8 per share, a new low for the year, before closing at $8¼, down $1 per share. Food Lion's Class B stock dropped from $10 per share to $8 5/8 per share, a decrease of $1 3/8 per share.

After the DOL announced two days later, on November 7, 1992, that it intended to bring a complaint against Food Lion alleging labor law violations, the company's Class A shares decreased by an additional $.50 per share on extremely heavy trading volume.

On August 3, 1993, the DOL reported that Food Lion had agreed to pay the largest settlement of a FLSA claim ever

negotiated, a total of $16.2 million to settle claims for its violations of federal laws regulating overtime, the minimum wage, and child labor. Even more significantly, DOL ordered Food Lion to submit detailed quarterly updates on reported labor violations, thus precluding Food Lion from enforcing policies inevitably resulting in widespread off-the-clock work that artificially inflated profits. Even today, Food Lion stock has not recovered.

## REASONS FOR GRANTING THE WRIT

As previously discussed, the Fourth Circuit concluded—in the face of undisputed evidence that the market discounted the UFCW's accusations that Food Lion was engaged in widespread violations of the FLSA—that the UFCW's allegations provided the market, as a matter of law, with "a full opportunity to evaluate these claims and to reflect their risk in the market price for Food Lion stock." (App. A). The Fourth Circuit's ruling that the presumption of reliance on a corporation's misrepresentations may be rebutted by establishing the existence of any contrary public statement, regardless of the market's view of the credibility of its source, cannot be harmonized with relevant decisions of this Court and directly conflicts with the decisions of other United States courts of appeals. A failure by a lower court to adhere to a decision of this Court is grounds for granting a writ of certiorari, Sup. Ct. R. 10(c); *see Pure Oil Co. v. Suarez*, 384 U.S. 202 (1966); *Heflin v. United States*, 358 U.S. 415 (1959), as is the existence of a Circuit split. Sup. Ct. R. 10(a); *see, e.g., Braxton v. United States*, 500 U.S. 344 (1991).

**THE COURT BELOW ERRED IN RULING THAT THE PRESUMPTION THAT PETITIONERS RELIED ON RESPONDENTS' MISREPRESENTATIONS WAS DEFEATED BY THE EXISTENCE OF PUBLIC STATEMENTS CONTRADICTING THE MISREPRESENTATIONS, NOTWITHSTANDING THE OVERWHELMING EVIDENCE THAT THE MARKET DID NOT CONSIDER THE SOURCE OF THE CONTRADICTORY STATEMENTS TO BE CREDIBLE.**

Petitioners' securities law claims arise under § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. To establish liability under § 10(b) and Rule 10b-5, petitioners must prove the following elements: (1) the respondents made a false or misleading statement or omission of material fact, *Basic Inc. v. Levinson*, 485 U.S. 224, 238 (1988), (2) with scienter, *Ernst & Ernst v. Hochfelder*, 425 U.S. 195, 196 (1976), (3) upon which the petitioners justifiably relied, *Id.* at 206 (4) that proximately caused the petitioners' damages, *e.g.*, *Gasner v. Board of Supervisors*, 103 F.3d 351, 356 (4th Cir. 1996).

The sole ground articulated by the court below for affirmance on the labor practices question was that the UFCW's September 11, 1991 press release fully disclosed to the market the existence of Food Lion's widespread illegal labor practices. Because a dispute of fact plainly exists as to whether the information of Food Lion's labor policies came from a source credible to the market, however, summary judgment should not have been granted.

This Court, in *Basic v. Levinson*, *supra*, instructed that when purchasers of stock on an open and developed market pursue a § 10(b) and Rule 10b-5 claim, they are relieved of proving the element of *direct* reliance. Rather, it is presumed that a materially false or misleading statement regarding a corporation or its business defrauded purchasers of its stock even if they did not directly rely on the statement because they are deemed to have relied instead on the integrity of the price set by the market. The Court reasoned as follows:

> The modern securities markets, literally involving millions of shares changing hands daily, differ from the face-to-face transactions contemplated by early fraud cases, and our understanding of Rule 10b-5's reliance requirement must encompass these differences. . . .
>
> Requiring a plaintiff to show a speculative state of facts, i.e., how he would have acted if omitted material information had been disclosed, . . . or if the misrepresentation had not been made, . . . would place an unnecessarily unrealistic evidentiary burden on the Rule 10b-5 plaintiff who has traded on an impersonal market. . . .
>
> Recent empirical studies have tended to confirm Congress' premise that the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material

> misrepresentations. . . . Because most publicly available information is reflected in market price, an investor's reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action.

485 U.S. at 243-47 (citations, footnotes omitted).

The *Basic* Court's discussion in *dicta* of methods that the defendant corporation in that case could rebut the presumption of fraud is significant here. The Court explained that one method of rebuttal was to show that news of the misrepresentation or omission "credibly entered the market and dissipated the effects of the misstatements." *Id.* at 249.

A year after *Basic* was issued, the Ninth Circuit published *Schneider v. Vennard (In re Apple Computer Sec. Litig.)*, 886 F.2d 1109 (1989), *cert. denied*, 496 U.S. 943 (1990). *Apple* has become the leading case on the method of rebutting the fraud on the market presumption by establishing that the market discounted the corporation's misrepresentations due to competing, credible information—an analysis termed by some courts as the "truth on the market" doctrine or corollary. *E.g., Provenz v. Miller*, 102 F.3d 1478, 1492 (9th Cir. 1996), *cert. denied*, 188 S. Ct. 48 (1997); *Associated Randall Bank v. Griffin*, 3 F.3d 208, 213-14 (7th Cir. 1993). Because the market necessarily places significant weight on a corporation's representations about its own operations, the *Apple* court emphasized that statements refuting a corporation's claims that are published by sources not deemed credible by the investing public should not operate to rebut the presumption:

We conclude that in a fraud on the market case, the defendant's failure to disclose material information may be excused where that information has been made credibly available to the market by other sources. The issue . . . is whether, in light of the press' documentation . . ., a rational jury could nonetheless find a "substantial likelihood" that full disclosures by Apple would have "significantly altered the 'total mix' of information made available." . . .

We stress the limits of our holding. Scrutiny by the press will not ordinarily excuse the type of unqualified exuberance expressed by Apple and its officers in this case. Even in a fraud on the market case, corporate insiders are not relieved of their duty to disclose material information where that information has received only brief mention in a few poorly-circulated or lightly-regarded publications. The investing public justifiably places heavy reliance on the statements and opinions of corporate insiders. *In order to avoid Rule 10b-5 liability, any material information which insiders fail to disclose must be transmitted to the public with a degree of intensity and credibility sufficient to effectively counter-balance any misleading impression created by the insiders' one-sided representations.*

886 F.2d at 1115-16 (emphasis added; quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438 (1976).

A number of other Circuits have adopted *Apple*'s holding that the fraud on the market presumption may sometimes be rebutted when information contradicting a corporation's false statements is sufficiently publicized. Until the Fourth Circuit's ruling in this case, however, *all* of the appellate courts adopting the "truth on the market" corollary have required that the source of the competing information be scrutinized to determine whether the market deemed it credible. *See, e.g., Shaw v. Digital Equip. Corp*, 82 F.3d 1194, 1214 n.25 (1st Cir. 1996) ("While evidence of actual market knowledge might be proper grist for the summary judgment mill on the question of materiality, it cannot be properly considered in evaluating whether plaintiffs' complaint is legally sufficient to survive a motion to dismiss under Rule 12(b)(6)"); *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 516 (7th Cir. 1989) (where competing information was sufficiently credible to affect stock price, fraud on the market presumption could be rebutted: "Prompt incorporation of news into stock price is the foundation for the fraud-on-the-market doctrine and therefore supports the truth-on-the-market doctrine as well"); *Sailors v. Northern States Power Co.*, 4 F.3d 610, 613 (8th Cir. 1993) (acknowledging that competing statements in poorly circulated or lightly regarded sources would not relieve corporation of duty to disclose material information, but concluding that, in light of "repeated references" in mass media and specialized press to information allegedly withheld by corporation and testimony of market analysts that the press reports negatively affected their analyses, nondisclosure

at issue "was public information that could have easily been obtained by any investor"); *Provenz v. Miller*, *supra*, 102 F.3d at 1493 (respondents seeking summary judgment on truth-on-the-market defense "bear a heavy burden of proof. . . . Summary judgment is proper only if [defendants] show that 'no rational jury could find' that the market was misled" (quoting *Kaplan v. Rose*, 49 F.3d 1363, 1376 (9th Cir. 1994))); *Berry v. Valence Tech., Inc.*, 175 F.3d 699, 706 (9th Cir. 1999) (in reversing summary judgment based on truth-on-the-market, court explained that Lev Dawson, the respondent corporation's founder and first CEO, "responded publicly to [a negative Forbes magazine] article immediately after it was published, refuting its allegations and claiming that [the corporation] was everything it purported to be. . . . Given the lack of any notable adverse market reaction or negative press follow-up, it would have been reasonable for a shareholder to read Dawson's letter and to conclude that nothing was amiss"); *In re Taxable Mun. Bonds Litig.*, [1994-1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,405 at 90,780 (E.D. La. Sept. 26, 1994) ("[I]t is a rare case in which the respondent can carry its 'staggering burden' under the truth on the market defense, particularly at the summary judgment stage"). *Cf. Grossman v. Novell, Inc.*, 120 F.3d 1112, 1122 (10th Cir. 1997) ("Particularly in a fraud on the market case, the relevant inquiry concerns the total mix of information available to the market at the time of the allegedly fraudulent statements"); *see generally* John M. Newman, Jr., et al., *Basic Truths: The Implications of the Fraud-On-The-Market Theory for Evaluating the "Misleading" and "Materiality" Elements of Securities Fraud Claims*, 20 J. Corp. L. 571, 576 (1995) ("Under [the truth on the market] doctrine, a defendant can escape liability

for a false statement—or one that reveals less than the full truth—by showing that the market was not affected by the misrepresentation because the truth of the matter was known already and had been factored into market prices. The issue of when the truth is actually 'on the market' often arises in such cases").

Indeed, the Fourth Circuit's analysis in this case undercuts the logic of the fraud on the market theory, articulated in *Basic*, that individual investors in modern securities markets simply cannot absorb all the information available to the market, but must instead rely on the price of a stock as a reflection of its value. 485 U.S. at 243-44. If the fraud on the market presumption can be rebutted as a matter of law by *any* public statement contradicting a corporation's misrepresentation—regardless of the credibility of its source or the statement's failure to affect the stock price—an investor will be required to scrutinize all available information to ensure the absence of any statement, whatever its source, that might later operate to rebut the fraud on the market presumption. *But see Finkel v. Docutel/Olivetti Corp.*, 817 F.2d 356, 360 (5th Cir. 1987) ("[T]he fraud on the market theory rejects the traditional notion of the investor who acts after carefully examining all available information"); *Ockerman v. May Zima & Co.*, 27 F.3d 1151, 1158 (6th Cir. 1994) (while "in a developed market, sophisticated financial professionals can generally be expected to read the publicly available information about a security . . . , unsophisticated investors generally rely on a security's market price as reflecting the security's value"); Note, *The Fraud-on-the-Market Theory*, 95 Harv. L. Rev. 1143, 1159 (1982) ("Most SEC disclosure documents not

only go unread by their intended recipients but in fact 'can be used effectively only by market professionals'" (quoting H. Kripke, THE SEC AND CORPORATE DISCLOSURE at 14 (1979))). It is straightforward that the Fourth Circuit's expansion of the truth on the market corollary defies the logic underlying the fraud on the market presumption.

## CONCLUSION

The Fourth Circuit erred in ruling—in the face of uncontroverted evidence that the market discounted as incredible the UFCW's accusations that Food Lion was engaging in widespread violations of the FLSA—that the UFCW's press release provided the market, as a matter of law, with "a full opportunity to evaluate these claims and to reflect their risk in the market price for Food Lion stock." The court's analysis disregards the teaching of *Basic*, is at odds with the decisions of every other appellate court that has addressed the issue, and defies reason. Accordingly, the lower court's order affirming summary judgment in favor of respondents should be reversed.

Respectfully submitted, this the 3rd day of February, 2000.

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(Any footnotes trail end of each document)

No. 98-2116

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

DAVID I. LONGMAN; JEFFREY FEINMAN; PAUL M. GARDNER, Defined Plan Trust; EDWARD HANKIN; LINDA HANKIN,
Plaintiffs-Appellants,

v.

FOOD LION, INCORPORATED; TOM E. SMITH,
Defendants-Appellees,

and

LYNNE NEUFER-DALE,
Respondent,

ROBERT HARBRANT; JEFFREY FIEDLER; KEITH MESTRICH; SEAN CUNNIFF; FOOD AND ALLIED SERVICE TRADES DEPARTMENT, AFL-CIO; RESEARCH ASSOCIATES OF AMERICA; NEEL LATTIMORE; NICHOLAS W. CLARK; MAUREEN DWYER; ALLEN Y. ZACK; CHARLES L. ULSCH; SUSAN BARNETT; COOPERS & LYBRAND, LLP,
Movants.

May 4, 1999, Argued

October 7, 1999, Decided

**COUNSEL:**
ARGUED: John Francis Bloss, Sr., CLARK & WHARTON, Greensboro, North Carolina, for Appellants.

Richard L. Wyatt, Jr., AKIN, GUMP, STRAUSS, HAUER & FELD, L.L.P., Washington, D.C.; William Kearns Davis, BELL, DAVIS & PITT, P.A., Winston-Salem, North Carolina, for Appellees.

ON BRIEF: David M. Clark, CLARK & WHARTON, Greensboro, North Carolina; Jeffery G. Smith, Shane Rowley, WOLF, HALDERSTEIN, ADLER, FREEMAN & HERTZ, L.L.P., New York, New York; Joseph H. Weiss, David C. Katz, WEISS & YOURMAN, New York, New York; Lubna Faruqi, FARUQI & FARUQI, New York, New York; B. Ervin Brown, II, MOORE & BROWN, Winston-Salem, North Carolina; Bernard Persky, GOODKIND, LABATON, RUDOFF & SUCHAROW, New York, New York, for Appellants.

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**JUDGES:**
Before WIDENER, MURNAGHAN, and NIEMEYER, Circuit Judges. Judge Niemeyer wrote the opinion, in which Judge Widener joined. Judge Murnaghan wrote a dissenting opinion.

**OPINIONBY:**
NIEMEYER

**OPINION:**

**OPINION**

NIEMEYER, Circuit Judge:

On the day after ABC aired its "PrimeTime Live" television broadcast on November 5, 1992, detailing allegedly widespread unsanitary practices and labor law violations in grocery stores owned by Food Lion, Inc., the price of Food Lion's Class A stock fell approximately 11%, and the price of its Class B stock fell approximately 14%. A week later, stockholders David Longman, Jeffrey Feinman, and others who had purchased Food Lion stock during the 2-1/2-year period before the broadcast filed these two class actions against Food Lion, which were later consolidated, alleging securities fraud under § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The plaintiffs alleged that Food Lion affirmatively misled the market and failed to disclose that its earnings during the 2-1/2-year period were artificially inflated due to its misrepresentations about and failure to disclose widespread violations of federal labor laws and pervasive, unsanitary food handling practices. They alleged that these violations and practices were attributable to Food Lion's "Effective Scheduling System," which required employees to perform certain duties within specified times at the risk of losing their jobs.

The district court granted Food Lion's motion for summary judgment, concluding as a matter of law that Food Lion did not knowingly fail to disclose labor or sanitation problems and finding that plaintiffs could not "prove

justifiable reliance" as to labor problems because they had already been disclosed and that the alleged sanitation problems were not material. For the reasons that follow, we affirm.

I

Food Lion is a publicly traded (over the counter) company with headquarters in Salisbury, North Carolina, that operates a chain of approximately 1,000 retail grocery stores in the southeastern part of the United States. During the relevant period, its earnings exceeded $ 200 million per year, and it employed about 60,000 persons.

As a management tool, Food Lion has employed a labor scheduling system, known as "Effective Scheduling," to assist department managers in scheduling their workforces based on the time that it should take an average employee to complete various tasks. While some stores have never met the goals set by the Effective Scheduling guidelines, others consistently have met those goals. In their complaints, plaintiffs alleged that the Effective Scheduling system established guidelines that were not attainable for many employees, thereby causing them to work "off the clock" without additional pay and to cut corners, including disregarding sanitary practices.

During the 2-1/2-year "Class Period" between May 7, 1990, when Food Lion issued its 1989 Annual report, and November 5, 1992, when the PrimeTime Live broadcast aired, plaintiffs purchased stock in Food Lion, allegedly relying on its rosy statements about its relationship with its employees and the cleanliness of its stores. Plaintiffs alleged that during this period, Food Lion "reported optimistically about its future" when, in fact, its profits and optimistic outlook were dependent on a system that required its

employees to violate the labor laws and to pursue unsanitary methods, facts which Food Lion failed to report.

In its 1989 Annual Report, circulated on May 7, 1990, Food Lion stated that the Human Resources Department "continues to insure that Food Lion employees receive competitive wages and excellent benefits;" that although inflation led to higher costs, "these costs were recovered primarily through improved operating efficiencies and an increased average selling price per item;" and that "we will continue to pay close attention to service levels and cleanliness in our stores and believe we will achieve high marks from customers in these areas." The report said nothing about any widespread labor or sanitary problems.

During the Class Period, Food Lion continued to face and to resist the efforts of the United Food and Commercial Workers Union ("UFCW") to organize Food Lion workers. When the union called for a boycott of Food Lion, the company issued a press release on August 30, 1990, stating:

> How ironic it is on this Labor Day weekend for a union leader to call for the destruction of more than 45,000 jobs of Food Lion employees in retaliation for their desire to remain union free. Such blatant threats and arrogant disregard of true employee free choice is the kind of coercion of employees that totally desecrates the purpose and spirit of Labor Day.
>
> The fact is, Food Lion opens more than 100 stores each year and adds more than 5,000 employees each year. Food Lion could not do this without offering competitive wages

> and excellent benefits. On average, Food Lion receives three to four applications for every available job.

About a year later, on September 11, 1991, the UFCW announced that it had filed a lengthy complaint with the Department of Labor, accusing Food Lion of widespread labor violations in tacitly encouraging employees to work "off the clock" without pay. In its press release, the union stated:

> More than 37 percent of the after-tax profit of the nation's fastest-growing retail food chain, Food Lion, is derived from illegal off-the-clock work of employees.
>
> * * *
>
> "Food Lion's profit is reported to exceed the industry average," the complaint [filed with the Department of Labor] states, "and its profit advantage is widely attributed to more efficient operations. With over one-third of its profit derived from illegal off-the-clock work, it is clear that Food Lion's profit advantage is unfairly obtained."
>
> * * *
>
> Food Lion could owe as much as $ 194 million in back wages. With liquidated damages allowed by law, its liability could be "as high as $ 388 million."

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Food Lion responded with its own press release the same day:

> Food Lion has a very clear policy against working off the clock. Employees, including managers, who have violated this policy have received discipline up to and including discharge.
>
> This Complaint and news release by the UFCW union is simply one more example of the union's attempt to harass and coerce Food Lion management into recognizing the union without regard to the sentiments of our employees.
>
> Food Lion employees have repeatedly rejected the UFCW union despite union efforts for more than ten years.
>
> * * *

As has been the case in all other attacks on Food Lion by this union, the company intends to defend itself vigorously in this matter.

On the following day, Food Lion issued another press release, stating:

> The UFCW's most recent claims of illegal employment practices by Food Lion and its employees insult the hard work and integrity of all Food Lion employees. Those ingredients are the key to Food Lion's

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> success and ability to bring customers extra low prices. It is not off the clock work by employees or other illegal employment practices as the UFCW-sponsored propaganda alleges.
>
> * * *
>
> Food Lion denies union claims of employee mistreatment, but the public doesn't have to accept the word of either the Company or the union. Let employees and the free marketplace decide that.
>
> * * *
>
> Nothing has been proven and nothing has been decided. Nevertheless, Food Lion is immediately commencing a detailed investigation of all the allegations in the Complaint and will take appropriate action.

Several months later, on February 27, 1992, Food Lion made further public statement with respect to the union's claims:

> As before, the UFCW union is simply exploiting administrative charges and other litigation as part of its effort to unionize Food Lion. The fact is, Food Lion strictly forbids working off-the-clock or other wage/hour law violations. UFCW sponsored claims of extensive wage/hour violations are

> simply untrue. Food Lion management diligently works to prevent even isolated occurrences. When management discovers them, those responsible receive appropriate discipline, and the misconduct is stopped.

Food Lion's 1991 Annual Report, circulated on June 1, 1992, referred to "continued and constant harassment of Food Lion by the United Food and Commercial Workers Union," but it also stated more positively, "We believe that Food Lion's Extra Low Prices and its clean and conveniently located stores are especially well suited to the demands of our customers." The report quoted a store manager as saying, "Food Lion also provides job security, good wages, good working conditions and some of the best benefits in the supermarket industry." The report also included an unattributed statement that "Food Lion is one of the best-managed high growth operators in the food retailing industry." This Annual Report, like the 1989 Annual Report, did not acknowledge any widespread labor violations or sanitation problems.

Finally, in July 1992, Food Lion filed a form 10-Q with the Securities and Exchange Commission which stated:

> Management and legal counsel for the Company are currently investigating and evaluating the allegations contained in the [UFCW] Complaints. The ultimate liability, if any, which may result is not presently determinable; however, in the opinion of management, the Company has meritorious defenses to the allegations and the Company intends to defend the allegations vigorously and any liability will not have a material

> adverse effect on the financial condition or results of operations of the Company.

On August 3, 1993, approximately one year after this public filing (and seven months after the close of the Class Period), the Department of Labor announced a settlement of the UFCW-instigated complaints against Food Lion, in which Food Lion agreed to pay $ 16.2 million, $ 8.1 million in 1993 and $ 8.1 million in 1994. The $ 16.2 million represented $ 13.2 million in back wages for current and former Food Lion employees and $ 3 million in penalties. The cost of the settlement to shareholders was 1.67 cents per share for each year, 1993 and 1994 (i.e., $ 8.1 million divided by the 484,000,000 shares outstanding). Experts retained by both the plaintiffs and the defendants agreed that the settlement was not material to Food Lion's earnings. Indeed, the expert for Food Lion stated that the settlement's effect on income was "de minimis."

On November 5, 1992, after all of the publicity about Food Lion's ongoing labor disputes but nine months before the Department of Labor settlement, ABC broadcast a PrimeTime Live episode about Food Lion stores, alleging widespread unsanitary practices and off-the-clock work by Food Lion employees. PrimeTime Live attributed these deficiencies to Food Lion's Effective Scheduling system. The broadcast included interviews with former and current Food Lion employees and a hidden camera investigation conducted by two ABC employees who obtained jobs at three Food Lion stores. The employees who were interviewed alleged various unsanitary business practices, including pulling meat out of a dumpster and selling it, bleaching fish and pork with Clorox "to get the smell out" and then selling them, mixing rotten pork with other pork and selling it as fresh sausage,

and cutting off the edge of a block of cheese that had been nibbled by rats so that the rest of the block could be sold. An employee stated that she used "fingernail polish remover to take the dates off" of products so that they could be sold after the manufacturer's date for sale had passed. The hidden camera investigation showed unsanitary practices, such as an employee being instructed to alter the expiration date on ham so that it could be sold weeks after its expiration date.

Several employees described how they worked extra hours off the clock in order to be able to complete their assigned tasks. Diane Sawyer, who narrated the broadcast, summarized:

> Over and over again, we were told that for workers, Food Lion is a kind of pressure cooker. The employees all said the company pays good salaries and has excellent benefits, including profit sharing. But there's a flip side, a time-management policy called Effective scheduling, which critics charge forces a lot of workers to finish the work on their own time.
>
> * * *
>
> Many employees told us that [the] pace [required by the Effective Scheduling system] is pounding. And since very little overtime is permitted, at the end of the day good workers were faced with an impossible choice. leave work unfinished, jeopardizing their jobs, or stay and finish, giving extra

> hours to the company without pay. It's called working off the clock, and it's illegal.

The day after the broadcast, Food Lion's Class A stock fell from $ 9.25 per share to $ 8.25 per share, and its Class B stock fell from $ 10.00 per share to $ 8.625 per share. Within a week, the plaintiffs in these cases filed their class action suits -- one on November 12, 1992, and the other on November 13, 1992 -- alleging that they purchased Food Lion stock based on artificially inflated earnings during the Class Period. They alleged that Food Lion's profits during that period before the broadcast had been attributable to these illegal practices and that Food Lion failed to disclose them to the market. The plaintiffs sued both Food Lion and its chairman of the board, president and chief executive officer, Tom E. Smith.

In its motion for summary judgment, Food Lion presented evidence that no corporate policy authorized or encouraged the unsanitary practices described in the PrimeTime Live broadcast. It stated that, on the contrary, it employs a team of auditors to ensure that its stores meet internal sanitation standards, as well as state and local regulatory standards. In addition, Food Lion pointed out that it is regularly subject to a variety of federal, state, and local inspections, including U.S. Department of Agriculture meat inspections, U.S. Food and Drug Administration surveys and evaluations, dairy inspections, and state and county food safety inspections. On the average, Food Lion stated that each store was inspected on an unscheduled, "surprise" basis between one and one and a half times per year by state or local health or agricultural inspectors. It claimed that it consistently received very high marks from state food sanitary authorities using numerical or alphabetical scales and

always passed inspection in states that use a pass/fail inspection system. In one affidavit, Food Lion asserted that its sanitation and food handling compliance record was as good as, and in many cases better than, the records of its principal competitors. Food Lion also stated that it has a customer relations department that receives and investigates customer complaints about the quality of store conditions and products. Food Lion presented evidence that it served approximately 400 million customers per year but only received, on average, less than one complaint per store per year regarding the quality of sanitation.

Food Lion also challenged the plaintiffs' claim of labor law violations, presenting information that it was Food Lion's policy to require employees to report all time worked. Food Lion acknowledged that it has occasionally received reports that an employee worked off the clock, but in each case it investigated the report and corrected any violation. Food Lion contended that it also audits its stores for off-the-clock work, and internal audits showed that off-the-clock work occurred relatively infrequently and that when such work did occur, it was addressed appropriately and effectively. Food Lion acknowledged that before the Class Period, it had been charged with off-the-clock work involving a small number of claims and that it had settled those claims with the Department of Labor for $ 300,000. However, Food Lion maintained that at no time during the Class Period did Food Lion become aware of any evidence of widespread violations of its policy against off-the-clock work.

The district court granted Food Lion's motion for summary judgment, concluding first that the plaintiffs were "unable to demonstrate that any alleged omission concerning isolated instances of workplace errors [involving sanitation] is actionable as a matter of law because there is not a

substantial likelihood that a reasonable investor would consider these isolated instances of workplace errors important in deciding whether to purchase Food Lion securities." In addition, as to the alleged labor violations, the court concluded that because the allegations had already been disclosed to the market, the plaintiffs were unable to prove "justifiable reliance on an alleged artificial stock price set by the market." Finally, the court concluded that the plaintiffs failed to offer evidence that defendants acted "with scienter by failing to disclose the alleged omission concerning working off the clock or the alleged omission concerning poor sanitation in Food Lion stores." For the same reasons, the court dismissed all related claims against Smith, as well as analogous claims alleged under state law.

This appeal followed.

II

The Securities Exchange Act of 1934, *15 U.S.C. § 78a* et seq., was "designed to protect investors against manipulation of stock prices" through a philosophy of public disclosure. *Basic Inc. v. Levinson, 485 U.S. 224, 230, 99 L. Ed. 2d 194, 108 S. Ct. 978 (1988); Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 477-78, 51 L. Ed. 2d 480, 97 S. Ct. 1292 (1977).* And it is well established that a private cause of action exists for violation of § 10b of the Act, *15 U.S.C. § 78j*(b), and for violation of Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder. See *Ernst & Ernst v. Hochfelder, 425 U.S. 185, 196-97, 47 L. Ed. 2d 668, 96 S. Ct. 1375 (1976).*

To establish liability under § 10b of the Securities Exchange Act and under Rule 10b-5, a plaintiff must prove that, in

connection with the purchase or sale of a security, "(1) the defendant made a false statement or omission of material fact (2) with scienter (3) upon which the plaintiff justifiably relied n1 (4) that proximately caused the plaintiff's damages." *Cooke v. Manufactured Homes, Inc., 998 F.2d 1256, 1261 (4th Cir. 1993)* (quoting *Myers v. Finkle, 950 F.2d 165, 167 (4th Cir. 1991))*; see also *Gasner v. Board of Supervisors, 103 F.3d 351, 356 (4th Cir. 1996).*

It is the first element that is at issue in this case -- whether Food Lion made a false statement or omission of material fact. To establish this element, plaintiffs must point to a factual statement or omission -- that is, one that is demonstrable as being true or false. See *Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1091-96, 115 L. Ed. 2d 929, 111 S. Ct. 2749 (1991)* (observing that even opinion in the proper context can be demonstrably true or false and therefore factual); see also 7 Louis Loss & Joel Seligman, Securities Regulation 3423 (3d ed. 1991). Also, the statement must be false, or the omission must render public statements misleading. See 17 C.F.R. § 240.10b-5. And finally, any statement or omission of fact must be material. Materiality is an objective concept, "involving the significance of an omitted or misrepresented fact to a reasonable investor." *Gasner, 103 F.3d at 356* (citing *TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 445, 48 L. Ed. 2d 757, 96 S. Ct. 2126 (1976))*. Thus, a fact stated or omitted is material if there is a substantial likelihood that a reasonable purchaser or seller of a security (1) would consider the fact important in deciding whether to buy or sell the security or (2) would have viewed the total mix of information made available to be significantly altered by disclosure of the fact. See *Basic, 485 U.S. at 231-32* (adopting standard from *TSC Industries, 426 U.S. at 448-49); Gasner, 103 F.3d at 356.*

These components -- a factual statement or omission that is false or misleading and that is material-- interact to provide a core requirement for a securities fraud claim. While opinion or puffery will often not be actionable, in particular contexts when it is both factual and material, it may be actionable. Thus, for example, a CEO's expression of "comfort" with a financial analyst's prediction of his company's future earnings was held not to be factual in that, as a future projection, it was not capable of being proved false. See *Malone v. Microdyne Corp., 26 F.3d 471, 479-80 (4th Cir. 1994);* see also *Raab v. General Physics Corp., 4 F.3d 286, 289 (4th Cir. 1993)* (holding similar statement predicting future growth not material because "the market price of a share is not inflated by vague statements predicting growth"). On the other hand, the Supreme Court has held that an opinion by board members to minority stockholders that the stock price of $ 42 for the purchase of their shares was a "high value" and represented a "fair" transaction could be both factual and material. See *Virginia Bankshares, 501 U.S. at 1090-93.* In Virginia Bankshares, the Court noted that the opinions could be false and factual if the directors did not believe what they said they believed and proof could be had "through the orthodox evidentiary process." *Id. at 1093.* In addition, the court found "no serious question" that the statements could be material in that shareholders, knowing that directors have greater knowledge and expertise as well as a fiduciary duty to shareholders, often act on what their board members say they believe. *Id. at 1090.*

With these relevant principles in hand, we turn to the misstatements and omissions that plaintiffs in this case allege "caused" them to purchase Food Lion stock during the Class Period.

III

The essence of the plaintiffs' claim is that during the Class Period, Food Lion's earnings were "artificially inflated due to Food Lion's widespread violations of federal labor laws and pervasive unsanitary food-handling practices" and that Food Lion failed to disclose these facts and, indeed, publicly denied them. Plaintiffs contend that the true facts were "first disclosed to the public in credible fashion" when ABC News aired PrimeTime Live on November 5, 1992, presenting "an expose on Food Lion's labor and sanitation practices." Relying on the "integrity of the market" theory, the plaintiffs claimed that they purchased Food Lion stock "at artificially inflated prices and [there fore] were damaged." They alleged further that "had the plaintiffs and the other Class members known the truth, they would not have purchased Food Lion's common stock at the prices they did or at all."

Plaintiffs thus make two claims: (1) that Food Lion's labor practices illegally "forced employees to work overtime without pay," resulting in overstated profits, and (2) that Food Lion's "widespread unsanitary conditions and sale of spoiled meat inflated sales." We address each claim in turn.

A

Throughout the Class Period, Food Lion expressed, in public statements, substantial pride in the fact that its employees were well-paid and enjoyed good benefits. It claimed that it provided its employees with job security, good working conditions, and "some of the best benefits in the supermarket industry." Its Annual Reports for 1989 and 1991 and similar public statements expressed a belief that "Food Lion is one of

the best-managed high growth operators in the food retailing industry."[2]

Plaintiffs claim that these rosy statements about employee compensation and benefits masked Food Lion's real labor problems that were created by its Effective Scheduling system and by the UFCW's complaint filed with the Department of Labor charging Food Lion with wage/hour violations. Plaintiffs' contention focuses on the allegation that Food Lion knew about employees being forced to work off the clock and that, even though the practice was widespread, it failed to disclose it. Because such work provided productivity from employees without compensation, the plaintiffs' theory goes, the practice illegally and artificially inflated Food Lion's earnings.

In addition, plaintiffs contend that, to the extent that the practices were made public by the UFCW and others, Food Lion's response was deceptive in explicitly denying or giving the implicit impression that it did not have significant amounts of off-the-clock work. For example, Food Lion said in response to the UFCW's complaint that it "intends to defend itself vigorously in this matter;" that the company's success was based upon the "hard work and integrity of all Food Lion employees," rather than on any "illegal employment practices;" and that "UFCW sponsored claims of extensive wage/hour violations are simply untrue." Likewise, in a filing with the SEC, Food Lion stated that while the "ultimate liability, if any, which may result [from the UFCW complaint] is not presently determinable. . ., in the opinion of management, the Company has meritorious defenses to the allegations and the Company intends to defend the allegations vigorously and any liability will not have a material adverse effect on the financial condition or results of

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operations of the Company." Plaintiffs also point to the fact that, during this same period, Food Lion omitted to admit that its profits were substantially dependent on this off-the-clock work.

Plaintiffs' securities fraud claim cannot succeed because, despite the fact that Food Lion denied the charges, the nature of the off-the-clock claims and the claims' risk to earnings were in fact well known to the market before the PrimeTime Live broadcast, and therefore Food Lion's omissions were not material. See *Hillson Partners Ltd. Partnership v. Adage, Inc., 42 F.3d 204, 212-13 (4th Cir. 1994)* (noting that the securities laws do not require disclosure of information that is already in the public domain). On September 11, 1991, for instance, more than a year before the PrimeTime Live broadcast, the UFCW publicly announced that it had filed a complaint with the Department of Labor, asserting that 183 people had claimed to have illegally worked off the clock, that "more than 37 percent of the after tax profit" of Food Lion was attributable to off the clock work, and that "Food Lion could owe as much as $ 194 million in back wages." The union warned that Food Lion's liability could be as high as $ 388 million based on claims for liquidated damages. Even as Food Lion denied the claims, however, it nevertheless promised to conduct an investigation of the allegations and take appropriate action. The market had a full opportunity to evaluate these claims and to reflect their risk in the market price for Food Lion stock. See *Raab, 4 F.3d at 289* (discussing "the presumption that the market price has internalized all publicly available information"). The PrimeTime Live broadcast added nothing to inform the market further. Rather, it simply repeated earlier charges through experiences of seven employees.

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Because the market was thus informed of the union's charges before PrimeTime Live aired, what PrimeTime Live disclosed was not material. Indeed, even the much larger problem alleged more than a year earlier by the union was not material. Food Lion settled all of the claims made by the union with the Department of Labor for $ 16.2 million, $ 8.1 million payable in each of 1993 and 1994. During the same period, Food Lion's earnings exceeded $ 200 million per year. Experts on both sides agree that this settlement, reflecting a charge of less than two cents per share for each year, was not material to Food Lion's stock price. And consistent with this conclusion, Food Lion's share price did not drop following announcement of the Department of Labor settlement.

In short, the off-the-clock violations disclosed during PrimeTime Live were already publicly available and, therefore, were not material either to Food Lion's earnings or the price of its stock. See *Gasner, 103 F.3d at 356.*

B

We turn now to the second category of alleged misstatements and omissions by Food Lion--those which related to unsanitary practices. The plaintiffs have juxtaposed Food Lion's ongoing public statements about the cleanliness of its stores with the PrimeTime Live broadcast which revealed allegedly widespread unsanitary practices. In its 1989 Annual Report, Food Lion stated: "We will continue to pay close attention to service levels and cleanliness in our stores and believe we will achieve high marks from customers in these areas." Similarly, in its 1991 Annual Report, Food Lion stated: "We believe that Food Lion's Extra Low Prices and its

clean and conveniently located stores are especially well suited to the demands of our customers."

On their face, these statements are the kind of puffery and generalizations that reasonable investors could not have relied upon when deciding whether to buy stock. See *Gasner, 103 F.3d at 356;* see also *Raab, 4 F.3d at 290* ("The market price of a share is not inflated by [such] vague statements"). Additionally, the plaintiffs have presented no evidence that Food Lion's stores were not generally clean or that customers complained about the lack of cleanliness in their stores. To the extent that the plaintiffs claim that these clean-stores representations masked the existence of unsanitary practices, they point to the broadcast from PrimeTime Live to support their claim.

Before considering the broadcast, the district court noted that, with a few exceptions, most of the broadcast was inadmissible hearsay. None of the people who spoke were under oath or subject to cross examination. In the absence of the evidence presented by the PrimeTime Live broadcast, or at least most of it, the district court was left with the affidavits of Food Lion which demonstrated that it had no corporate policy, written or unwritten, that would permit or encourage unsanitary food-handling practices. The court noted that Food Lion had "an audit staff in place who conducted surprise inspections of Food Lion stores to ensure that the stores complied with health and sanitation policies." And the court concluded that Food Lion's efforts were apparently sufficient to satisfy federal, state, and local inspections which revealed that Food Lion's record was "just as good, if not better, than its competitors' inspection reports."

But even considering the entire PrimeTime Live broadcast, the district court stated it "still does not present evidence of widespread unsanitary conditions of which Defendants knew." It noted that "with respect to the sanitary conditions at Food Lion's 1,000 stores, the [PrimeTime Live] broadcast is insufficient to draw any conclusions about Food Lion's operations as a whole." The court pointed out that the broadcast was filmed at only 3 of Food Lion's almost 1,000 stores and that out of 60,000 active employees and 40,000 former employees, PrimeTime Live interviewed a total of 70 current and former employees, 22 of whom had left the employ of Food Lion as much as 8 years before the Class Period. The district court concluded:

> To the extent that there are any isolated instances of workplace errors, . . . not only is there not a substantial likelihood that the reasonable investor would consider the limited instances of workplace errors important in deciding whether to purchase Food Lion securities, but the Court also finds . . . that Defendants were taking steps to remedy these isolated problems. As a result, the Court finds that to the extent that there is any omission by Defendants in their Annual and Quarterly Reports of isolated instances of workplace errors, this omission not only is not material as required by § 10b but also could not make any affirmative statements misleading in Defendants' Annual and Quarterly Reports.

(Citations omitted).

We agree with the district court that, based on the record in this case, Food Lion was not required to make public statements about the existence of various sanitation problems that were revealed from time to time. These day-to-day conditions were not shown to be material to the price of Food Lion's stock. We also agree, as earlier noted, that the public statements that it did make were no more than soft, puffing statements about clean and conveniently located stores that no reasonable investor could rely upon in buying or selling Food Lion stock. Accordingly, we conclude that Food Lion did not defraud the market with false statements or omissions of material fact as required to maintain an action under § 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder. See *Hillson Partners, 42 F.3d at 219* (noting that materiality depends on the "magnitude" of the event in light of total company activity).

IV

Plaintiffs also sued Tom E. Smith, the CEO of Food Lion, under § 20(a) of the Securities Exchange Act, which provides:

> Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly

> induce the act or acts constituting the violation or cause of action.

*15 U.S.C. § 78t*(a). Even if Tom Smith had sufficient "control" over Food Lion such that he could be held liable under § 20(a) for any of the alleged securities violation by Food Lion, we conclude that because there is no evidence of any such violation in this case, Tom Smith cannot be held liable, vicariously or otherwise.

For the foregoing reasons, the judgment of the district court is

AFFIRMED.

----------Footnotes----------

[1] Where, as here, a plaintiff pursues a securities fraud action based on a fraud-on-the-market theory, he may, to demonstrate reliance, rely on a presumption of direct reliance created by his reliance on the integrity of the market.

> In face-to-face transactions, the inquiry into an investor's reliance upon information is into the subjective pricing of that information by that investor. With the presence of a market, the market is interposed between seller and buyer and, ideally, transmits information to the investor in the processed form of a market price. Thus the market is performing a substantial part of the valuation process performed by the investor in a face-to-face transaction. The market is acting as the unpaid agent of the investor, informing him that given all the

> information available to it, the value of the stock is worth the market price.

*Basic, 485 U.S. at 244* (quoting *In re LTV Sec. Litig., 88 F.R.D. 134, 143 (N.D. Tex. 1980)).* Accordingly, where material false statements or omissions have been disseminated to "an impersonal, well-developed market for securities, the reliance of individual plaintiffs on the integrity of the market price may be presumed." *485 U.S. at 247;* see also *Malone v. Microdyne Corp., 26 F.3d 471, 476 n.5 (4th Cir. 1994).* But this fraud-on-the-market presumption is rebuttable. See *Basic, 485 U.S. at 250;* see also *id. at 251* ( White, J., concurring in part and dissenting in part) (agreeing with the majority that the presumption "must be capable of being rebutted by a showing that a plaintiff did not 'rely' on the market price").

In this case, the parties apparently agree that the market for Food Lion's stock is well-developed and efficient, and there is no suggestion that plaintiffs did not rely on the market price of Food Lion's stock.

[2] While not material to our holding, we note that we can find nothing in the record that would make these general statements by Food Lion, standing alone, actionable. First, these statements are immaterial puffery that is not actionable under the securities laws. See, e.g., *Raab, 4 F.3d at 289-90; Howard v. Haddad, 962 F.2d 328, 331 (4th Cir. 1992).* Second, there is no evidence in the record that Food Lion employees were not well paid; that Food Lion did not have "some of the best benefits" in the industry; or that Food Lion was not well managed. Third, whether or not these statements are true, they do not bear on plaintiffs' claims that Food Lion forced its employees to work off the clock. Even if Food

Lion's employees worked overtime without pay, they could still be well paid compared to other employees in the industry.

**DISSENTBY.**
MURNAGHA

**DISSENT:**

MURNAGHAN, Circuit Judge, dissenting:
I respectfully dissent. The majority opinion claims that Food Lion's failure to disclose its "off the clock" policy was not material because the market was fully informed of any risks in the price of Food Lion's stock. The majority relies on the press reports reflecting the dispute between Food Lion and the UFCW over Food Lion's employment practices. In doing so, the majority cites *Hillson Partners Ltd. Partnership v. Adage, Inc., 42 F.3d 204 (4th Cir. 1994),* and *Raab v. General Physics Corp., 4 F.3d 286 (4th Cir. 1993).*

In Hillson Partners and Raab, the corporation-defendants made misleading statements to the market about their economic situations. In both cases, however, the defendants admitted their financial problems through additional public disclosures. See *Hillson Partners, 42 F.3d at 212* (defendant disclosed the financial problems of its subsidiary in its Annual Report and a Form 10K filing); *Raab, 4 F.3d at 289* (defendant issued a press release informing the market of an impending reduction in its earnings on the same day as the misleading statements in its Annual Report). Because the market had access to the defendants' financial problems, we held that the misleading statements were not material to the plaintiffs' decisions to purchase stock. See *Hillson Partners, 42 F.3d at 212-13; Raab, 4 F.3d at 289.*

Hillson Partners and Raab do not control the case at bar. The majority incorrectly suggests that any public information contradicting Food Lion's misleading statements forecloses the possibility of finding that those statements were material. However, the controlling principle is that "in a fraud on the market case, Food Lion's failure to disclose material information may be excused where that information has been made credibly available to the market by other sources." *Raab, 4 F.3d at 289* (quoting *In re Apple Sec. Litig., 886 F.2d 1109, 1115 (9th Cir. 1989)* (emphasis added)); see also *Basic Inc. v. Levinson, 485 U.S. 224, 248-49, 99 L. Ed. 2d 194, 108 S. Ct. 978 (1988)*. The majority does not analyze whether the allegations against Food Lion came from a credible source.[1]

Here, the market first heard about Food Lion's problems through an employment dispute between Food Lion and the UFCW. Food Lion had been resisting the efforts of the UFCW to organize Food Lion's workers. In August of 1990, the UFCW called for a boycott of Food Lion's stores to protest Food Lion's opposition to the union. Food Lion responded by accusing the UFCW of "the kind of coercion of employees that totally desecrates the purpose and spirit of Labor Day." The public thus was aware that Food Lion and the UFCW were involved in a bitter dispute over whether Food Lion's stores would unionize.

In September of 1991, the UFCW filed its complaint with the Department of Labor, citing Food Lion's policy of encouraging "off the clock" work by employees. Food Lion responded by denying the UFCW's claim. Food Lion also suggested that the claim was an effort to use unmeritorious litigation to force Food Lion to unionize. Food Lion stated in a public statement that "as before, the UFCW union is simply exploiting administrative charges and other litigation as part of its effort to unionize Food Lion . . . . UFCW sponsored

claims of extensive wage/hour violations are simply untrue." Food Lion thus characterized the UFCW's claim as merely another tactic in an ongoing labor dispute.

The information available to the public when the plaintiffs purchased Food Lion stock came from an admitted adversary of Food Lion. Given the history of antagonism between the parties and Food Lion's vehement denials, the information about Food Lion's policies did not come from a credible source. A dispute of fact, therefore, exists as to whether Food Lion's representations were material to the plaintiffs' decisions to purchase Food Lion stock.

Because a dispute of fact exists as to whether Food Lion's representations were material, the district court's grant of summary judgment to Food Lion was inappropriate. I would reverse the district court's grant of summary judgment in favor of Food Lion.[2]

---Footnotes---

[1] Obviously, we did not have to analyze whether the negative information in Hillson Partners and Raab came from a credible source. In both cases, the information came from the defendant's own statements.

[2] For the same reasons, I would reverse the district court's grant of summary judgment in favor of defendant Tom Smith.

4:92CV696, 4:92CV705

UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF NORTH CAROLINA

DAVID I. LONGMAN,
Plaintiff,

v.

FOOD LION, INC. and TOM E. SMITH,
Defendants.

JEFFREY FEINMAN, PAUL N. GARDNER DEFINED PLAN TRUST and EDWIN HANKIN and LINDA HANKIN,
Plaintiffs,

v.

FOOD LION, INC. and TOM E. SMITH, Defendants.

January 4, 1999, Decided

January 4, 1999, Filed

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**JUDGES:**
James A. Beaty, Jr., United States District Judge.

**OPINIONBY:**
James A. Beaty, Jr.

**OPINION:**

MEMORANDUM OPINION

BEATY, District Judge.

This matter is before the Court pursuant to Plaintiffs' Motion to Strike Confidentiality Order [Document # 234]. Plaintiffs request that all of the documents and material in the judicial record be released from the seal which was imposed on confidential documents as part of the Court's December 2,

1994 Confidentiality Order. For the reasons that follow, Plaintiffs' request is denied.

## I. FACTUAL BACKGROUND

On June 18, 1998, the Court granted Defendants' Motion for Summary Judgment and thereby resolved the underlying dispute in this case. The facts of the dispute are fully set forth in the Memorandum Opinion accompanying that Order. Plaintiffs have appealed the summary judgment decision to the Fourth Circuit.

However, the current dispute revolves around the Confidentiality Order entered during discovery in this case. During pretrial discovery, Defendants moved for a protective order to limit discovery of confidential business information pursuant to Fed. R. Civ. P. 26(c). On March 16, 1994, the Court granted Defendants' request for a protective order, and directed the parties to "meet and determine whether or not they [could] stipulate to the contents of this order." The parties agreed to a Confidentiality Order, which was entered by the Court on December 2, 1994.

Under the terms of the Confidentiality Order, any party had the power to stamp discovery material as "confidential." Material stamped "confidential" could only be disclosed to certain parties who needed access for purposes of this litigation. Under the Order, a party could challenge the "confidential" designation by filing an application with the Court challenging the confidentiality of a specific document or category of documents. For discovery material submitted to this Court in connection with a motion to dismiss or motion for summary judgment, any discovery material designated as "confidential" was required to be filed under seal.

Defendants turned over numerous documents during discovery, with many documents and categories of documents stamped "confidential." Plaintiffs did not challenge any of the confidentiality designations during discovery. Plaintiffs submitted much of this discovery material to the Court, including over nine binders of documents, at the summary judgment stage. All of the material that was stamped "confidential" was filed under seal, as required by the Confidentiality Order.

Plaintiffs now seek to generally strike the Confidentiality Order, at the very least as it pertains to material that is part of the "judicial record." Thus, Plaintiffs seek to unseal the entire record on appeal, and request full public disclosure of the discovery material in the nine volumes submitted in connection with the summary judgment motion. Plaintiffs claim that they are proceeding under Paragraph Twelve of the Confidentiality Order, which provides that "nothing in this order shall prevent any party or other person from seeking modification of this order . . . ."

## II. PROCEDURAL POSTURE

Local Rule of Appellate Procedure 10(d) provides that "in the rare event that a change of circumstances occurs during the pendency of an appeal that warrants reconsideration of a sealing issue decided below, or initial consideration of the need to seal all or part of the record on appeal, an appropriate motion may be filed with the Clerk of the Court of Appeals. . . . Material contained in the record subject to a protective order remains subject to that order on appeal unless modified or amended by the Court of Appeals." Defendants contend that under this rule, Plaintiffs' motion may only be brought

before the Fourth Circuit while the case is on appeal, and may only be brought if Plaintiffs can indicate a "change of circumstances during the pendency of [the] appeal."

However, under Local Rule 10(d), "the Court of Appeals expects that motions to seal all or any part of the record will be presented to, and resolved by, the lower court . . . during the course of trial, hearing, or other proceeding below." In addition, under Local Rule 10(e), "disputes concerning the accuracy or composition of the record on appeal should be resolved in the trial court in the first instance." When the Fourth Circuit was presented with a similar motion to unseal a record while the case was on appeal in Rushford v. New Yorker Magazine, Inc., the Fourth Circuit chose to remand the case to the district court to resolve the issues that were raised for the first time in that motion. See *Rushford, 846 F.2d 249, 250-51 (4th Cir. 1988)*. The Fourth Circuit remanded the motion, despite the fact that Local Rule 10(d) provided that "material contained in the record subject to a protective order remains subject to that order on appeal unless modified or amended by the Court of Appeals." Local R. App. P. 10(d) (1988).

Plaintiffs' motion is currently pending before this Court, and, in this Court's view, it would not be an effective use of judicial resources to decide the issue on procedural grounds without reaching the merits, only to have the Fourth Circuit remand the case to this Court for a determination of the merits of these newly raised issues. Therefore, this Court will consider Plaintiffs' motion to strike the Confidentiality Order, while acknowledging that the Fourth Circuit may conclude that such a motion to unseal the record is best directed to that Court for initial consideration during the pendency of an appeal, pursuant to Local Rule 10(d).

## III. ANALYSIS

### A. Standard for Modification of Discovery Order

The standard for modifying a protective order depends on whether the parties were required to demonstrate good cause for the issuance of the order, whether the parties relied on the order, and whether the parties stipulated to the terms of the order. Based on a consideration of all of these factors in this case, Plaintiffs bear the burden of establishing the need for modification of the protective order.

Rule 26(c) allows a court to issue a protective order on a showing of good cause. If the parties agree to a protective order and it is entered without a showing of good cause, the party who later seeks to keep information confidential will bear the burden of showing good cause. However, if the party seeking protection was required to show good cause initially, the burden will be on the party seeking modification of the order. See *Bayer AG and Miles, Inc. v. Barr Laboratories, Inc., 162 F.R.D. 456, 463-64 (S.D.N.Y. 1995)*. In this case, Defendants moved for a protective order during pretrial discovery. On March 16, 1994, the Court granted the request for a protective order, necessarily finding that good cause was established.

Discovery in this case involved hundreds of documents containing confidential business information that Defendants feared could be used by Defendants' competitors to gain a business advantage. The Court therefore instructed the parties to try to stipulate to the terms of the order, which was entered based on the original finding of good cause. The parties agreed to a "blanket" protective order that permitted them to designate documents containing confidential business information. The arrangement was essential to the efficient functioning of the discovery process, and was entered based

on a general "good cause" determination. Cf. *id. at 465.* Therefore, to the extent that Defendants made a good cause showing in obtaining the initial protective order, the burden now shifts to Plaintiffs to show good cause as to why the confidentiality order should be modified or stricken.

It is particularly appropriate to hold the Plaintiffs to this burden where Plaintiffs stipulated to the terms of the protective order and Defendants relied on that protection. See *Bayer, 162 F.R.D. at 465* ("Where, however, the modification motion is brought by a party who stipulated to a blanket protective order, the party should be held to its agreement and thus should have the burden of showing good cause for its modification request."); *Omega Homes, Inc. v. Citicorp. Acceptance Co., 656 F. Supp. 393, 404 (W.D.Va. 1987)* ("When, however, the proposed modification affects a protective order stipulated to by the parties . . . it is clear that the shared and explicit assumption that discovery was for the purposes of one case alone goes a long way toward denying the movant's request without more."); *Jochims v. Isuzu Motors, Ltd., 145 F.R.D. 499, 501 (S.D. Iowa 1992)* ("There is general unanimity among the courts that where a party to [a] stipulated protective order seeks to modify that protective order, that party must demonstrate particular good cause in order to gain relief from the agreed to protective order.").

Here, Plaintiffs agreed to the terms of the protective order and did not challenge any of the confidentiality designations during discovery. Defendants relied on this protection in producing documents. Now, Plaintiffs seek to modify the protective order so that they can submit the record on appeal without the administrative burden of filing it under seal. Plaintiffs also seek to provide the discovery material to the class members and the public at large. The Court does not accept either of these arguments as the type of "good cause"

that must be shown to justify modifying a protective order. Plaintiffs have failed to show sufficient reason to strike the confidentiality order in its entirety and release all discovery material to the public. Therefore, Plaintiffs' motion to strike the December 2, 1994 Confidentiality Order previously entered in this matter is denied.

B. Access to the Judicial Record

Plaintiffs also argue that material submitted to the Court as part of the summary judgment consideration is part of the judicial record and should be unsealed based on the common law presumption of access to judicial records and the First Amendment right of access. Plaintiffs are correct that judicial seals are generally disfavored, and materials considered by the Court in granting a motion for summary judgment are part of the judicial record and subject to the common law presumption of access and the First Amendment right of access. See *Rushford, 846 F.2d at 252-54.*

However, unlike the situation in Rushford, this case does not involve an intervenor seeking to unseal the record based on the public's right of access. Instead, this case involves a claim by Plaintiffs, who agreed to the provisions of the confidentiality order, including the sealing of the documents, and who now seek to escape their agreement based on access arguments that they bargained away. It is not appropriate to allow a party to agree to a protective order, only to attempt to undo their agreement at the last possible moment. See *Zenith Radio Corp. v. Matsushita Elec. Indus. Co., Ltd., 529 F. Supp. 866, 894 (E.D. Pa. 1981)* (noting that a party who voluntarily entered into a protective order to facilitate discover "effectively waived their right to seek wholesale declassification"). Therefore, because Plaintiffs agreed to the Confidentiality Order, the Court will not entertain their First Amendment and public access arguments.[1]

This approach was sanctioned by the Fourth Circuit in an analogous context in *United States v. Morgan, 962 F.2d 8, 1992 WL 102573 (4th Cir. 1992)*, an unpublished opinion which this Court uses only for illustrative purposes. There, the parties had litigated the initial imposition of a seal, and later one party attempted to unseal the document based on First Amendment arguments. The Fourth Circuit noted that:

> at a minimum, these concerns strongly counsel against requiring the full analysis argued for by the appellant. Requiring the full complement of procedural requirement set forth in *In re Knight Publishing Co., 743 F.2d 231, 235 (4th Cir. 1984)*, would amount to a full and complete relitigation of the issue every time a motion was made to unseal the documents. We believe a more appropriate balance was drawn by the court below. Where the motion is brought by a party that has had a full opportunity to litigate the initial imposition of the seal, the appropriate threshold question is whether or not that party has shown a change in circumstance sufficient to warrant a reconsideration of the seal.

Id. In this case, the parties did not litigate the protective order; instead, Plaintiffs agreed to the order, failed to object to confidentiality designations, and only now seek to raise public access arguments. When a motion is brought by a party who is represented by counsel who agreed to the terms of a protective order, that party is estopped from raising access arguments that they bargained away. Cf. *Omega*

*Homes, 656 F. Supp. at 404* ("The court refuses to endorse Omega's tactic of inducing broad disclosure under a set of ground rules and of then avoiding any limitations on itself by asking the court to come in and change those rules."); *West Virginia v. Moore, 902 F. Supp. 715, 718 (S.D.W.Va. 1995)* (estopping a party from maintaining that a deposition was not confidential where the party failed to seek resolution of the issue during discovery); *Zenith, 529 F. Supp. at 894* ("All parties have relied on these provisions in producing documents, and wholesale declassification would undermine their justified expectations. Plaintiffs cannot now attempt to undo what they have willingly wrought; having made their bed, they must sleep in it.").

Finally, even if Plaintiffs could bring this public access argument, the appropriate solution would not be to strike the confidentiality order and release the record in its entirety. A wholesale release of the record would be particularly inappropriate in a case such as this, where Plaintiffs submitted over nine volumes of documents, many of which could be sealed even given the public access requirements because they contain Defendants' trade secrets, confidential business information, or information protected by attorney-client privilege. See *Nixon v. Warner Communications, Inc., 435 U.S. 589, 598, 55 L. Ed. 2d 570, 580, 98 S. Ct. 1306 (1978).* Defendants would normally be given an opportunity to raise confidentiality arguments in favor of sealing sensitive information in the record. However, Defendants did not have the opportunity to make these arguments when the documents were released to Plaintiffs or when they were submitted by Plaintiffs to the Court, because Defendants relied on the protective order that Plaintiffs had agreed to. In these circumstances, considering Plaintiffs' request for release while still providing the appropriate

protection for Defendants would require this Court to undertake a document-by-document review of all the material in the record. However, Plaintiffs cannot now request such a document-by-document review because Plaintiffs failed to exercise their rights under the confidentiality order to challenge confidentiality designations during the course of discovery. The Court will hold Plaintiffs to their agreement, and will refuse to allow a wholesale declassification of all documents at this late stage. Cf. *Doctor's Hosp. of Jefferson, Inc. v. Southeast Medical Alliance, Inc. 878 F. Supp. 884, 885-886 (E.D. La. 1995)* (denying plaintiff's motion to lift protective order as to all exhibits prepared for trial because plaintiff failed to specifically identify the documents it believed should not be protected); *Zenith, 529 F. Supp. at 893-894* (discussing the impropriety of wholesale declassification years after discovery began where the party failed to make any contemporaneous objection to the confidentiality designation).

## IV. CONCLUSION

The Court concludes that Plaintiffs have failed to show good cause for modification of the protective order. In addition, because Plaintiffs agreed to the protective order and the sealing provisions, the First Amendment and presumption of access arguments are not available to support Plaintiffs' request. Even if these arguments were available to Plaintiffs, wholesale declassification of the record would be inappropriate in this case. Therefore, Plaintiffs' Motion to Strike Confidentiality Order is DENIED, and the Confidentiality Order as entered on December 2, 1994 remains in effect. An Order consistent with this

Memorandum Opinion will be filed contemporaneously herewith.

This the 4th day of January, 1999.

James A. Beaty, Jr.

United States District Judge

ORDER

BEATY, District Judge.

For the reasons enumerated in the Memorandum Opinion filed contemporaneously herewith, IT IS HEREBY ORDERED that Plaintiffs' Motion to Strike Confidentiality Order [Document # 234] is DENIED, and the Confidentiality Order as entered by the Court on December 2, 1994 remains in effect.

This the 4th day of January, 1999.

James A. Beaty, Jr.

United States District Judge

----------Footnotes----------

[1] This analysis does not affect the separate question of the ability of an appropriate intervenor who was not a party to the protective order to raise an interest in the documents under seal.

Nos. 4:92CV00696, 4:92CV00705.
United States District Court, M.D. North Carolina.

LONGMAN, et al.,

v.

FOOD LION, INC., et al.
Oct. 17, 1994.

ERWIN, District Judge.
Facts

On November 5, 1992, The American Broadcasting Company, in its "Prime Time Live" network television program, reported the findings of a six-month long investigation it had conducted into Food Lion's operation and practices. This investigation included research which utilized hidden cameras and involved interviews with numerous employees at several Food Lion stores.

The November 5, 1992 broadcast revealed for the first time that Food Lion had concealed from its customers the company's practice of:

(a) selling rotten meat and fish products by, among other things, bleaching them in Clorox covering them with barbecue sauce, grinding them with sausage mixture, and repackaging them with false expiration dates;

(b) altering expiration dates on products such as eggs, yogurt, cheese and meats, by using fingernail polish remover;

(c) trimming portions of cheese which had been eaten by rats and putting it out for sale; and

(d) removing spoiled food from dumpsters and putting it out for sale.

First Amended Complaint of David I. Longman at ¶¶ 26(a)-(d); Complaint of Jeffrey Feinman, et al. at ¶¶ 28-36.

The Complaint sets forth numerous alleged misstatements by the Defendants contained in various Securities and Exchange Commission (SEC) filings. The Complaint alleges violations of Sections 10(b) and 20(a) of the Securities and Exchange Act, 15 U.S.C. §§ 78j(b), 78t(a) (1934), as well as a violation of Rule 10(b)-5 of the SEC. Additionally, there are alleged state law claims of fraud and deceit and negligent misrepresentation.

Issues Presented

I. Have Plaintiffs satisfied Local Rule 212?
II. Are the alleged violations of federal securities law proper for class certification?
III. Are Plaintiffs proper representatives of both Class A and Class B Stock?
IV. Is the proposed class period appropriate?
V. Should Plaintiffs' pendent claims be certified for class treatment?

I. Local Rule 212

Local Rule 212(d), M.D.N.C., provides that "[t]he burden shall be upon any party seeking to maintain a case as a class action to present an evidentiary basis to the court showing that the action is properly maintainable as such."

Class determination is made at the advent of an action; therefore, the allegations contained in the complaint, including the class action allegations, are accepted for the purposes of the class motion. See Eisen v. Carliele & Jacquelin, 417 U.S. 156, 177-78 (1974); Stastny v. Southern Bell Tel. & Tel. Co., 628 F.2d 267, 275 (4th Cir.1980); Doctor v. Seaboard C.L.R. Co., 540 F.2d 699, 708-09 (4th Cir.1976).

The Complaint makes factual allegations to substantiate the necessary elements for certification under Rule 23(a) and 23(b)(3) of the Federal Rules of Civil Procedure. Local Rule 202(d), M.D.N.C., provides that "[w]hen allegations of facts not appearing of record are relied upon to support a motion, affidavits, parts of depositions, and other pertinent documents then available shall accompany the motion." (Emphasis added.)

The Court finds that the plaintiffs complied with Local Rule 212. Sufficient factual allegations have been made to establish the necessary elements for class certification.

II. Class Certification

When considering a motion for the certification of a class, the allegations of the complaint must be taken as true. Simpson v. Specialty Retail Concepts, Inc., 149 F.R.D. 94. 97 (M.D.N.C.1993) (quoting Blackie v. Barrack, 524 F.2d 891, 901 n. 17 (9th Cir.1975), cert. denied, 429 U.S. 816 (1976)). Taking the allegations in the Complaint as true, the Court finds that the alleged violations of federal securities laws are well suited for class action. Rule 23 is to be construed liberally to effectuate this end. Simpson, 149

F.R.D. at 98. See also Kahan v. Rosenstiel, 424 F.2d 161, 169 (3d Cir.1970), cert. denied, 398 U.S. 950 (1970).

To proceed with a class action, the Court must find the four prerequisites enumerated in Rule 23(a). Additionally, at least one of the requirements of Rule 23(b) must be satisfied. Rule 23(a) requires that at least one member of a class may sue or be sued as representative parties of all only if: (1) the class is so numerous that joinder of all members is impracticable; (2) there are questions of law or fact common to the class; (3) the claims or defenses of the representative are typical of the claims or defenses of the class; and (4) the representative parties will fairly and adequately protect the interest of the class.

Subsection 23(b) requires that common questions of fact or law predominate and that a class action be superior to other methods of adjudication.

A. Numerosity

In securities fraud actions brought against publicly owned and nationally listed corporations, the numerosity requirement has been met by a showing that a large number of shares were outstanding and traded during the relevant period. Simpson, 149 F.R.D. at 99. See also Garfinkel v. Memory Metals, Inc., 695 F.Supp. 1397, 1401 (D.Conn.1988). The numerous shareholders of Food Lion stock coupled with the substantial purchases during the class period are sufficient to establish the numerosity as required by Rule 23(a)(1).

B. Commonality

The commonality requirement of Rule 23(a)(2) is often applied in the context of securities fraud litigation. Moskowitz v. Lopp, 128 F.R.D. 624, 628 (E.D.Pa.1989). "In the 10b-5 context, misrepresentation in annual reports, interim reports, and press releases have been found to satisfy the common question requirement." Simpson, 149 F.R.D. at 98. See Blackie, 524 F.2d at 902. The federal claims alleged in the Complaint contain elements of fraud that would be common to the Class.

C. Typicality

The typicality requirement is met if plaintiffs' claims arise from the same course of conduct that gives rise to the claims of other Class members and is based on the same legal theory. Simpson, 149 F.R.D. at 98. See also In re Kirschner Medical Corp. Sec. Litig., 139 F.R.D. 74, 79 (D.Md.1991).

D. Fair and Adequate Representation by Class Representatives

The requirements for adequate representation under Rule 23(a)(4) are that the named plaintiffs have no conflict of interest with the class and that a qualified and experienced attorney is obtained for the purpose of litigation. Id. at 101. See also South Carolina National Bank v. Stone, 139 F.R.D. 325, 329-31 (D.S.C.1991) (holding a plaintiff's adequacy to represent class is determined by plaintiff's counsel's ability to vigorously prosecute the matter).

1. Mr. Longman

The Court finds that there is ample evidence in the record to conclude that Longman, in conjunction with his counsel, can

fairly and adequately support the interest of the Class. There is nothing that requires a plaintiff to possess encyclopedic knowledge of the legal theories supporting a class' claims in order to be a class representative. Accordingly, Mr. Longman shall be a Class representative.

2. Mr. Gardner

The Court finds that there is substantial evidence in the record to conclude that Mr. Gardner will provide vigorous representation of the Class. The Defendants have offered no evidence of how Mr. Gardner's participation in other legal proceedings does anything but indicate that he is able to serve as a representative in this matter. It is incontrovertible that participation in prior securities litigation, without other significant disabling factors, is not relevant to a proposed class representative's adequacy.

Accordingly, Mr. Gardner shall be a Class representative.

3. Mr. Hankin

The Defendants contend that since Mr. and Mrs. Hankin purchased 200 shares of Food Lion stock as tenants by the entireties, Mr. Hankin is not a typical and adequate class representative. Defendants contend that since Mrs. Hankin does not want to be a named party in the suit, Mr. Hankin lacks standing. To establish standing, the Hankins only need to establish that they are members of the Class. Sosna v. Iowa, 419 U.S. 393, 401 (1975), citing Rosario v. Rockefeller, 410 U.S. 752 (1973); Hall v. Beals, 396 U.S. 45 (1969). It is not contested that both Mr. and Mrs. Hankin will be members of the Class; therefore, the only question that remains with respect to class certification is whether Mr.

Hankin will "fairly and adequately protect the interests of the class." Sosna, 419 U.S. at 403. The evidence in the record reveals that Mr. Hankin, with the assistance of his counsel, will fairly and adequately represent the interests of the Class; therefore, he shall be a Class representative.

E. Common Issues of Fact and Law

Rule 23(b) requires that common questions of law and fact predominate over questions affecting individual members. Additionally "the Court must determine whether the class action device is superior to other methods of adjudication." Simpson, 149 F.R.D. at 102.

With respect to the alleged federal securities violations, the individual issues will involve reliance and damages. Those issues become significant only if the Class can demonstrate the common elements of material misrepresentation and/or omissions and scienter. Id. The Court finds that the common issues predominate over the individual issues. Additionally, the Court finds that the class action device is superior to other methods of adjudication.

III. Class A and Class B Stock

The court, in Sanders v. Robinson Humphrey/American Express, 634 F.Supp. 1048, 1057 (N.D.Ga.1986), cert. denied, 485 U.S. 959 (1988), stated that "[w]hen plaintiffs have alleged such a common course of conduct, courts consistently have found no bar to class certification even though members of a class may have purchased different types of securities or interests, or purchased similar securities at different times."

In Endo v. Albertine, 147 F.R.D. 164, 167-68 (N.D.Ill.1993), defendants argued that plaintiffs who had bought only Class A common stock could not also represent purchasers of debentures and notes. The court firmly rejected this contention, stating:

These claims are equally applicable to stock and debenture holders. The facts and legal theories asserted by the class to prove any violations will be identical regardless of the type of security at issue. Backie v. Barrack, 524 F.2d 891, 911 n. 27 (9th Cir.1975). The only difference between the claims for the different types of securities is that any violation may have affected the value of each differently. (Citations omitted.) This difference does not make the claims of the purchasers of each type of security atypical of the others. The defendants point to no claim under which the positions of the holders of the different types of securities would be adverse. There is no question here that the claims of both the named plaintiffs and the debenture holders arose "from the same event or practice or course of conduct that [gave] rise to the claims of other class members and [their] claims are based on the same legal theory". See Rosario, 963 F.2d at 1018. Therefore, we find that plaintiffs have shown that the class claims are typical under Rule 23(a)(3).

Id. at 167-68 (alterations in original). The Court finds that the Plaintiffs are the appropriate representatives for both Class A and Class B stock.

IV. The Proposed Class Period

The plaintiffs propose a class period beginning March 31, 1990. This is the date on which the Defendants allegedly began withholding information. The Defendants contend that

May 7, 1990 is the appropriate starting date since the first alleged misrepresentation was made on this date. The Court finds that May 7, 1990 is the proper starting date for the class period. The Food Lion Annual Report was filed with the Securities and Exchange Commission on May 7, 1990. This is the first alleged misrepresentation; therefore, it could not have been relied upon by investors prior to this date.

Accordingly, the class period shall begin May 7, 1990 and extend through November 5, 1992.

V. Pendent Common Law Claims

Courts have split on the issues presented by certification of pendent securities claims. Priest v. Zayre Corp., 118 F.R.D. 552, 557 (D.Mass.1988). See Gruber v. Price Waterhouse, 117 F.R.D. 75, 81 (E.D.Pa.1987) (referencing the divergent judicial perspectives regarding the question of whether individual issues predominate as to common law claims).

In Kirkpatrick v. J.C. Bradford & Co., 827 F.2d 718, 725 (11th Cir.1987), the court found "that the differing standards of liability required by the laws of the various states would render class action treatment unmanageable," and determined that the state law claims failed to satisfy the requirements of Rule 23(b)(3).

Although there are undoubtedly differences among the various applicable state laws, it remains uncertain at this time whether there exists such a substantial variation among the states with regard to the common law claims as to outweigh the commonality of legal and factual issues otherwise present in this litigation. Kirschner, 139 F.R.D. at 84. See In re Energy Systems Equipment Leasing Securities Litigation,

642 F.Supp. 718, 753 (E.D.N.Y.1986). Accordingly, Plaintiffs' pendent claims will be provisionally certified as a Class along with the federal securities claims. Should problems relating to conflicting state laws or other issues of management arise as to the pendent claims, the Court will reconsider the certification of those claims at that time. Simpson, 149 F.R.D. at 103; See Kirschner, 139 F.R.D. at 85 n. 5.

## Conclusion

The Court GRANTS the Plaintiffs' Motion to Certify Class.

The Class shall include all persons who purchased the common stock of Food Lion, Inc. from May 7, 1990 through November 5, 1992 and were damaged thereby. Excluded from the Class are Defendants herein, members of the immediate families of the individual Defendants, any entity in which any Defendant has a controlling interest, and Defendants' legal representatives, heirs, successors, predecessors-in-interest, or assigns of any Defendant.

Plaintiffs David I. Longman, Jeffrey Feinman, Paul N. Gardner Defined Plan Trust, and Edwin Hankin shall be representatives of said Class.

Pursuant to Rule 23, the Court retains the power to adjust or reconsider its decision. Simpson, 149 F.R.D. at 104.

## ORDER

Consistent with the Memorandum Opinion filed contemporaneously herewith, the federal securities claims[1] along with the pendent state claims[2] shall proceed as a class action pursuant to Federal Rules of Civil Procedure 23(a) and

23(b)(3) on behalf of the following class: all persons who purchased the common stock of Food Lion, Inc., from May 7, 1990 through November 5, 1992, and were damaged thereby. Excluded from the Class are defendants herein, members of the immediate families of the individual defendants, any entity in which any defendant has a controlling interest, and defendants' legal representatives, heirs, successors, predecessors-in-interest, or assigns of any defendant.

Plaintiffs David I. Longman, Jeffrey Feinman, Paul N. Gardner Defined Plan Trust, and Edwin Hankin shall be representatives of said Class.

Pursuant to Rule 23, the Court retains the power to adjust or reconsider its decision. Simpson, 149 F.R.D. at 104.

IT IS SO ORDERED.

Footnotes

[1]. 15 U.S.C. §§ 78(j) and 78t(a), and Rule 10(b)5 of the Securities and Exchange Act of 1934.

[2]. The pendent state law claims are for fraud and negligent misrepresentation.

Dated 6/18/98

4:92CV696, 4:92CV705

UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF NORTH CAROLINA

DAVID I. LONGMAN,
Plaintiff,

v.

FOOD LION, INC. and TOM E. SMITH,
Defendants.

JEFFREY FEINMAN, PAUL N. GARDNER DEFINED PLAN TRUST and EDWIN HANKIN and LINDA HANKIN,
Plaintiffs,

v.

FOOD LION, INC. and TOM E. SMITH, Defendants.

MEMORANDUM OPINION

BEATY, District Judge.

This matter is presently before the Court on Defendant Food Lion, Inc.'s ("Food Lion") Motion for Summary Judgment [Document # 190], Defendant Tom E. Smith's ("Tom Smith" or collectively "Defendants") Motion for Summary Judgment [Document # 188], and Plaintiffs'

Motion for Partial Summary Judgment [Document # 192]. This matter is further before the Court on Plaintiffs' Motion to Strike or, in the alternative, Motion to Respond [Document # 223] to Defendants' reply briefs [Documents # 221 & 222] on the inadmissability of certain evidence before this Court. For the reasons stated herein, Plaintiffs' Motion to Strike or, in the alternative, Plaintiffs' Motion to Respond is hereby DENIED. Defendant Food Lion's Motion for Summary Judgment and Defendant Tom Smith's Motion for Summary Judgment are hereby GRANTED and this action is DISMISSED. Plaintiffs' Motion for Partial Summary Judgment is hereby rendered MOOT.

## I. FACTS

Plaintiffs originally brought these consolidated class actions fn1 against Food Lion, a North Carolina based supermarket chain, and its President, Chief Executive Officer, and Chairman of the Board of Directors, Tom E. Smith. The plaintiff class consists of all persons or entities who purchased Food Lion's securities from May 7, 1990 through November 5, 1992 (the "Class Period"). fn2 In the Complaint, Plaintiffs allege causes of action for securities fraud under §§ 10(b) fn3 and 20(a) fn4 of the Securities Exchange Act of *1934, fn5* and 17 C.F.R. § 240.10b-5 ("Rule *10b-5")6 fn6* promulgated by the Securities Exchange Commission under §10(b) of the Securities Exchange Act of 1934. Plaintiffs also allege state law claims for fraud, deceit, and negligent misrepresentation. Except for Plaintiffs' § 20(a) claim, Plaintiffs bring all of these claims against both Food Lion, Inc. and Tom Smith. Plaintiffs bring the § 20(a) claim against only Tom Smith as a controlling person.

Plaintiffs brought this securities fraud action shortly after a sharp decline in the market value of Food Lion stock following a November 5, 1992 broadcast of the television show PrimeTime Live ('PTL"). Plaintiffs allege that the broadcast revealed that Food Lion had in place a time management policy called "Effective Scheduling" which allegedly forced employees to work off the clock. (Am. Compl. ¶ 27.) Plaintiffs also allege and contend, based upon the content of the PTL broadcast, that Food Lion increased its earnings and margins by engaging in (1) the selling of rotten food by, among other things, bleaching it in Clorox, covering it with barbeque sauce, grinding it with sausage mixture, and repackaging it with false expiration dates; (2) the unwrapping of products that had passed the manufacturer's "sell by" date, trimming off the edges of spoiled meats, and repackaging and redating the products with new extended expiration dates; (3) the trimming of portions of cheese that had been eaten away by rats and selling the remaining portions to consumers; and by (4) illegally working off the clock and cutting corners by avoiding certain non-immediate tasks such as sanitation-related duties. (Am. Compl. ¶ 26.)

Relying upon these allegations, Plaintiffs have filed the present securities fraud claims against Food Lion and Tom Smith based on several statements, made by Defendants in Food Lion's Annual and Quarterly Reports, which Plaintiffs contend were misstatements, were misleading, or were rendered misleading because Defendants omitted material information concerning the effects of Food Lion's Effective Scheduling System on Food Lion's net profits and sanitation. (Am. Compl. ¶35.) Plaintiffs further claim that the market was not aware of these material omissions until the PTL broadcast on November 5, 1992. (See Am. Compl. ¶ 26.) Plaintiffs contend that what they describe as materially

misleading statements in and omissions from Defendants' Annual and Quarterly Reports caused the securities market to set an artificially high price for Food Lion stock. (Id.)

Defendants Food Lion and Tom Smith have moved for summary judgment on Plaintiffs' securities fraud claims. In a separate motion, Plaintiffs have moved for partial summary judgment on Defendants' affirmative defenses numbered thirteen through eighteen.fn7 A hearing was held on February 18, 1998 on all of the motions raised by Plaintiffs and Defendants. At the conclusion of the hearing, the Court allowed Defendants to provide the Court with supplemental briefs in order that Defendants could address the question of the admissibility of certain evidence before this Court. The Court granted Plaintiffs ten days to respond to Defendants' supplemental briefs. After Plaintiffs filed their responsive briefs, Defendants filed reply briefs to Plaintiffs' responsive briefs. Plaintiffs have now moved to strike Defendants' reply briefs. In the alternative, Plaintiffs have moved for leave to respond to Defendants' reply briefs. The Court will first address Plaintiffs' Motion to strike and alternative Motion to Respond. The Court will then address Defendants' and Plaintiffs' motions for summary judgment.

## II. PLAINTIFFS' MOTION TO STRIKE and MOTION TO RESPOND

In Plaintiffs' Motion to Strike Defendants' reply briefs, Plaintiffs raise what they contend are several problems with Defendants' reply briefs: (1) Defendants are not entitled to reply to Plaintiffs' responsive briefs, which deal with evidentiary issues raised in connection with Defendants' motions for summary judgment, (2) these reply briefs are not in the proper font as required by the Local Rules, and (3)

these reply briefs contain new material not addressed in Plaintiffs' responsive briefs. Addressing whether or not Defendants are entitled to reply to Plaintiffs' responsive briefs, the Court notes that at the conclusion of the February 18, 1998 hearing, the Court allowed Defendants to provide the Court with supplemental briefs to their original motions for summary judgment. Plaintiffs were also allowed leave to file responsive briefs to Defendants' supplemental briefs in order to address further the admissibility of the evidence. It was anticipated by the Court that Defendants would then file reply briefs to Plaintiffs' responsive briefs. The Court finds that this procedure, relating to the filing of briefs in connection with a motion, as well as the font of Defendants' reply briefs, are both consistent with Local Rule 7.3. See L.C. 7.3 (e), (f), & (h) (allowing for supporting briefs, responsive briefs, and reply briefs on motions before the Court). The Court further finds that Defendants' reply briefs to Plaintiffs' responsive briefs do not contain new material and that these reply briefs simply address the arguments raised in Plaintiffs' responsive briefs. The Court will therefore deny Plaintiffs' Motion to Strike Defendants' reply briefs. The Court will also deny Plaintiffs' alternative Motion to Respond to Defendants' reply briefs. As to the evidence that is discussed in these briefs—that is, the PTL broadcast, the "Simonsen Letter," and statements made by Secretary Reich fn8—to the extent that this evidence may be relevant to the issues addressed in this Memorandum Opinion, the Court will address the admissibility of this evidence in the discussion of the motions for summary judgment.

## III. STANDARD OF REVIEW FOR SUMMARY JUDGMENT

Summary judgment is appropriate when "there is no issue as to any material fact and. . . the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c). In making this determination, the Court views the evidence in the light most favorable to the non-moving party, according that party the benefit of all reasonable inferences. Bailey v. Blue Cross Blue Shield of Va., 67 F.3d 53, 56.(4th Cir. 1995), cert. denied, 516 U.S. 1159, 116 S. Ct. 1043, 134 L. Ed. 2d 190 (1996). Judges are not "required to submit a question to a jury merely because some evidence has been introduced by the party having the burden of proof, unless the evidence be of such character that would warrant the jury in finding a verdict in favor of that party." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 251, 91 L. Ed. 2d 202, 213 (1986) (quoting Schuylkill & Dauphin Improvement & R.R. Co. v. Munson, 81 U.S. (14 Wall) 442, 448, 20 L. Ed. 867, 872 (1872)). However, a motion for summary judgment should not be granted "unless the entire record shows a right to judgment with such clarity as to leave no room for controversy and establishes affirmatively that the adverse party cannot prevail under any circumstances." Campbell v. Hewitt. Coleman & Assoc.. Inc., 21 F.3d 52, 55 (4th Cir. 1994) (quoting Phoenix Say. & Loan, Inc. v. Aetna Cas. & Sur. Co., 381 F.2d 245, 249 (4th Cir. 1967)).

## IV. DISCUSSION

### A. PLAINTIFFS' SECURITIES FRAUD CLAIM UNDER SECTION 10(b)

This action was filed as a securities fraud case. In order to establish liability for securities fraud under § 10(b) of the Securities Exchange Act, and Rule 10b-5 promulgated thereunder, plaintiff must prove (1) that the defendant made a

false statement or omission of material fact, (2) with scienter, (3) upon which the plaintiff justifiably relied, and (4) which proximately caused the plaintiff's damages. Cooke v. Manufactured Homes. Inc., 998 F.2d 1256, 1261 (4th Cir. 1993). Defendant Food Lion argues that it is entitled to summary judgment because, as a matter of law, Plaintiffs are unable to establish liability under § 10(b) of the Securities Exchange Act, or Rule 10b-5 promulgated thereunder, based on any statements or omissions which Plaintiffs contend are in violation of this Act. Defendant Tom Smith joins in Food Lion's Motion for Summary Judgment and has also filed his own Motion for Summary Judgment arguing that if Plaintiffs have failed to establish primary liability under § 10(b), then he is entitled to summary judgment on Plaintiffs' § 20(a) claim against him as a controlling person. See In re Cryomedical Sciences, Inc. Sec. Litig., 884 F. Supp. 1001, 1011 (D Md. 1995) (stating that if plaintiff fails to show § 10(b) or Rule 10b-5 primary liability, then plaintiff also fails to show § 20(a) secondary liability); Shapiro v. UJB Financial Corp., 964 F.2d 272, 279 (3rd Cir.), cert. denied, 506 U.S. 934, 113 S. Ct. 365, 121 L. Ed. 2d 278 (1992).

In support of their theory that Defendants made certain statements which Plaintiffs contend were misstatements, or were misleading, or which Plaintiffs contend omitted certain facts which rendered these statements misleading, Plaintiffs have identified the following representations made by Tom Smith on behalf of Food Lion:

(1) Food Lion's 1989 Annual Report:

> (a) "In addition to the focus on new store growth, Food Lion has continued its aggressive re-set and remodeling program, in

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order to maintain all Food Lion stores in excellent condition for our customers. We improved many of our stores in 1989 by installing scanning equipment, new meat and frozen food cases and in-store coolers. Our goal is to provide our customers with modern, efficient stores in which to shop."

(b) "In 1989, same store sales continued to grow, which allowed the Company to spread its fixed costs over a larger revenue base. This growth demonstrates the increased acceptance of Food Lion's "Extra Low Prices" in the marketplace. In addition, our focus on the grocery business allows us to fine tune our operations to satisfy customer needs, which we believe is a big factor in same store sales growth. Our company has no plans to engage in any peripheral business as many of our competitors do. We will continue to pay close attention to service levels and cleanliness in our stores and believe we will achieve high marks from customers in these areas."

(c) "We believe the future holds exciting opportunities for Food Lion. Though competition remains fierce and many other retailers continue to aggressively compete with supermarkets, we are confident of our ability to remain a strong force in supermarketing."

(d) "Challenges in 1990 include effectively addressing environmental concerns, food safety, health issues and customer

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convenience. The demand for precooked and microwavable products will continue to grow and our ability to provide fresh vegetable and fruits will be an important part of our operation.

We are ready for the challenges of 1990 and will take advantage of appropriate opportunities in this dynamic marketplace."

(e) "for the 22nd consecutive year Food Lion achieved record sales and earnings. Sales were $4.7 billion, a 23.6% increase over fiscal 1988. Earnings reached $139.8 million, up *24.2%* over 1988. . . Food Lion remains one of the fastest growing supermarket chains in America."

(2) Food Lion's 1990 Annual Report:

(a) "Food Lion strives to stay ahead of the competition and stay on top of new trends and new technology. We constantly develop and evaluate new retailing strategies to address the needs of our customers. Recent examples include our emphasis on foods that can be prepared quickly, which led us to expand food areas and equip all stores with upright freezer cases. In addition, as a result of our customer's concerns for a healthier lifestyle, we have added many new products. We also take advantage of up-to-date technology in order to promote efficiency at both management and retail levels."

(b)"Future Plans

Our goal for 1991 and future years is to achieve consistent, quality growth. We are convinced that Food Lion's commitments to extra low prices, quality, service and variety will enable us to achieve this goal."

(3) Food Lion's Quarterly Report for the quarter ending September 7, 1991:

"The Company's gross profit percentage increased O.76% and .40% of sales for the quarter and the year to date, respectively. Customer trends towards convenience, with increased purchases of frozen and ready-to-eat foods continue to favorably impact gross profits. These items generate strong gross profits. Other factors contributing to the gross profit increase are lower LIFO charges and favorable purchasing contracts negotiated by the Company in conjunction with the opening of three new distribution centers."

(4) Food Lion's 1991 Annual Report:

(a) "Food Lion is one of the best-managed high growth operators in the food retailing industry."

(b) "During 1991, Food Lion continued to see increased emphasis by our customers on both prices and store convenience. We believe that Food Lion's Extra Low Prices and its clean and conveniently located stores are especially well suited to the demands of our customers and enable us to effectively compete with all existing and potential competition, including conventional supermarkets, combination stores and warehouse clubs. We believe that the

American consumer will demand low prices, convenient stores and a full range of products. Food Lion is well positioned to meet this demand."

(c) "Gross Profit

Gross profit was 20.7% of sales in 1991, 20.36% in 1990 and 20.03% in 1989. Gross profit improved as a result of increased merchandising and operating efficiencies, favorable purchasing contracts and a lower LIFO charge in 1991."

(d) "Selling and Administrative Expenses

The Company's cost containment philosophy continues to produce a ratio of selling and administrative expenses to sales that is significantly below the industry average."

(e) "The Company achieved its 24th consecutive year of record sales and earnings. Sales for 1991 were $6.44 billion compared to $5.58 billion in 1990 and *$4.72* billion in 1989 representing increases of 15.3%, 18.4% and 23.6%, respectively. . . . The 1991 same store sales growth of 2.7% ranks among the highest in the supermarket industry during 1991."

(5) Food Lion's Quarterly Report for the quarter ending September 5, 1992:

"The Department of Labor has advised the Company that its investigation has disclosed what it terms 'substantial' overtime and child labor violations. The ultimate liability, if any, which may result is not

> presently determinable because, among other reasons, the Department of Labor has not fully disclosed to the Company the results of its investigation; however, in the opinion of management of the Company, the Company has
> meritorious defenses to the allegations and the Company intends to defend the allegations vigorously. Based on currently available information, any liability will not have a material adverse effect on the financial conditions or results of operations of the Company."

(Am. Compl. ¶¶ 17-23, 25) (emphasis added by Plaintiffs).fn9 Although Plaintiffs do not claim that these statements are actionable as false statements of material facts, Plaintiffs do claim that these statements are actionable because, as Plaintiffs contend, Defendants omitted material information from these statements. For example, in Plaintiffs' Memorandum of Law in Opposition to Food Lion's Motion for Summary Judgment, Plaintiffs explain these omissions, which are the gravamen of their case, as follows:

> Food Lion and its CEO, Tom Smith, issued statements to the public while concealing material information that rendered those statements misleading. Food Lion's public filing statements regarding its higher than industry standard profit margins omitted to state the extent to which those margins were based on illegal and, hence, unsustainable labor practices. Food Lion's public statements about its efficient use of labor and high regard for good sanitation practices and healthful food handling and food products omitted to state the extent to which its brutal Effective Scheduling System . . .

> which forced employees to work off the clock . . . is in violation of the Fair Labor Standards Act . . . and caused employees to skimp on good sanitary food handling standards.

(Pls.' Mem. of Law in Opp'n to Food Lion's Mot. for Summ. J. at 1) (emphasis added). Plaintiffs contend that these alleged omissions are material because while Defendants were making statements in their Annual and Quarterly Reports, as set forth above, a reasonable investor would want to know, as Plaintiffs allege, that Food Lion was engaging in violations of the Fair Labor Standards Act ("FLSA") and had widespread sanitation problems as a result of its Effective Scheduling System. However, as the Court will discuss below, the Court finds that there are no genuine issues of material fact, and Defendants are entitled to summary judgment as a matter of law, as to Plaintiffs' securities fraud claims based on these alleged omissions as set forth above. In making this determination, the Court will discuss the alleged omissions as they relate to the prima facie case, as set forth in Cooke, as follows: (1) under the materiality element, the Court will address the alleged omission concerning poor sanitation, (2) under the justifiable reliance element, the Court will address the alleged omission concerning working off the clock, and (3) under the scienter element, the Court will address both of the alleged omissions as set forth above.

1. Materiality and the Alleged Omission Concerning Poor Sanitation

The first prong of the prima facie case, that the defendant made a false statement or omission of material fact, has two components. Hillson Partners Ltd. Partnership v.

Adage. Inc., 42 F.3d 204, 208-09 (4th Cir. 1994). The first component requires Plaintiffs to show that Defendants made a false statement or omission of fact. Id. at 209. The second component requires that the false statement or omission be material. Id. As Judge Motz explained in Hilison Partners,

> [I]n order "to fulfill the materiality requirement" in the § 10(b) and Rule 10b5 context "there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available" Thus, materiality is a "fact-specific inquiry," which "depends on the significance the reasonable investor would place on the withheld or misrepresented information."

Id. at 209 (quoting Basic, Inc. v. Levinson, *485* U.S. 224, 23 1-32, 108 S. Ct. 978, 983, 99 L. Ed. 2d 194) (11988) (citation and internal quotation marks omitted). Although materiality "requires delicate assessments of the inferences 'a reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him," TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 450, 96 S. Ct. 2126, 2133, 48 L. Ed. 2d *757,* 766 (1976), materiality is appropriately resolved as a matter of law, and summary judgment should be granted, when "no rational finder of fact could conclude that the alleged misrepresentations and omissions were material." Connelly v. General Medical Corp., 880 F. Supp. 1100, 1113 (E.D. Va. 1995); see also Johns Hopkins v. Hutton, 422 F.2d 1124, 1129 (4th Cir. 1970) (stating that summary judgment

may be granted when "reasonable minds cannot differ on the question of materiality").

As stated previously, Plaintiffs argue that statements made by Food Lion in its Annual and Quarterly Reports concerning its high regard for good and safe food handling practices were rendered misleading because, as Plaintiffs contend, Food Lion omitted to disclose how its brutal Effective Scheduling System forced employees to cut corners and engage in activities that resulted in widespread unsanitary store conditions. (See Pls.' Mem of Law in Opp'n to Food Lion's Mot. for Summ. J. at 1.) As to this alleged omission, Defendants claim that there is no evidence that demonstrates that Food Lion was aware of any widespread sanitation problem throughout its 1000 stores as a result of the Effective Scheduling System and that Plaintiffs evidence only shows occurrences of isolated instances of workplace errors in a few of Food Lion's stores. Consequently, Defendants have moved for summary judgment claiming that, even accepting Plaintiffs' evidence of occurrences of isolated instances of workplace errors in Food Lion stores, the revelation of these few instances of workplace errors in sanitation is not material as a matter of law.

a. The Alleged Omission of Widespread Sanitation Problems

In support of their motions for summary judgment, with respect to the alleged omissions concerning widespread sanitation problems, Defendants argue that the evidence shows that Food Lion had no reason to believe that its food handling and sanitation practices were anything but proper. For example, Defendants' evidence shows that Food Lion

received high marks in federal, state, and local inspection reports and that these reports were just as good, if not better, than its competitors' inspection reports. (Buckley Aff. ¶ 11; Godwin Aff. ¶ 7; McCanless Aff. ¶ 40.) In addition, the Effective Scheduling System, which the Plaintiffs contend caused employees to engage in unsanitary practices, had built into the system fixed hours for every store that these stores were required to use for sanitation and cleaning. (Dawson Aff. ¶ 5; Dinse Aff. ¶ 10; Franklin Aff. ¶ 9; Gilley Aff. ¶ 6; Godwin Aff. ¶8.)

Furthermore, Defendants have proffered evidence which shows that there was no corporate policy, written or unwritten, that would permit or encourage the practices alleged in the Complaint relating to sanitation and food-handling. (Bundy Aff. ¶ 7; Bumgarner Aff. ¶ 7; Curtis Aff. ¶ 3; Dawson Aff. ¶ 9; Dinse Aff. ¶ 9; Hall ¶ 4.) For example, Food Lion had an audit staff in place who conducted surprise inspections of Food Lion stores to ensure that the stores complied with health and sanitation policies. (Adams Aff. ¶ 10; Buckley Aff. ¶ 10; Bundy Aff. ¶ 4; Curtis Aff. ¶ 4; Dawson Aff. ¶ 8; Gehl Aff. ¶ 3; Gilley Aff. ¶ 4; Herbert Aff. ¶4.) These findings were reported in written reports to Food Lion management. (Gehi Aff. ¶ 3.) If substantial problems were found, the auditors would conduct follow-up visits until the problems were corrected. (Id. ¶ 4; Oelkers ¶ 5; S. Smith ¶ 4.) Food Lion was attentive to the conditions in its stores to the extent that any violation of Food Lion's sanitation policy which came to management's attention resulted in employee discipline, up to and including discharge. (Adams Aff. ¶ 10; Buckley Aff. ¶ 10; Bundy Aff. ¶ 4; Dawson Aff. ¶ 7.)

Finally, Food Lion had in place a Consumer Relations Department which handled customer complaints and

prepared, on a monthly basis, a summary of all negative customer comments. (McCanless Aff. ¶ 36.) During the Class Period, even though Food Lion served approximate'y 400 million customers per year, on average, customer complaints regarding the quality or sanitation of Food Lion stores were less than one complaint per store per year. (Id.; Kluttz Aff. ¶ 5.)

On the other hand, Plaintiffs rely on the PIL broadcast, fn10 statements made by Secretary of Labor Robert Reich in a Department of Labor ("DOL") news release, the "Simonsen Letter," and a few additional Food Lion memoranda that will be discussed below, to support their contention that Food Lion followed poor sanitation and food handling practices. Plaintiffs contend that this evidence creates a genuine issue of material fact about whether Defendants knew of widespread sanitation problems throughout its stores.

Before addressing what is disclosed in the PTL broadcast, the Court must first address whether this broadcast is inadmissible hearsay." This is an important determination because hearsay evidence, which is not admissible at trial, cannot be considered on a motion for summary judgment. See Maryland Highways Contractors Ass'n, Inc. v. Maryland, 933 F.2d 1246, 1251 (4th Cir.), cert. denied, *502* U.S. 939, 116 L. Ed. 2d 325 (1991). Defendants argue that the PTL broadcast is inadmissible hearsay because Plaintiffs offer the broadcast to prove the truth of Plaintiffs' allegations that Food Lion had material widespread problems with sanitation. In response, Plaintiffs offer several reasons, which the Court will discuss below, to explain why the statements made in the video either are not hearsay or fall within an exception to the hearsay rule. After reading the transcript of the broadcast,

(see Pls.' Ex. A, attached to Pls.' Resp. to Defs.' Supp. Mem. on the Admiss. of PTL), the Court finds that the broadcast contains statements made by several different types of people—that is, (1) statements by then current employees who were filmed undercover without their knowledge (2) statements by Kim Caudill while being interviewed by Diane Sawyer, who also was at the time of the interview an employee of Food Lion, (3) statements by former employees, (4) statements and questions by the two ABC employees while filming the undercover footage, and (5) questions and comments by Diane Sawyer. fn12

First, Plaintiffs argue that the statements made by the then current Food Lion employees while being filmed undercover are admissible pursuant to Rule 801(d)(2)(D) (admission a party opponent statement by party agent) of the Federal Rules of Evidence. Rule 801(d)(2)(D) provides that "[a] statement is not hearsay if--- (2) The statement is offered against a party and is (D) a statement made by the party's agent or servant concerning a matter within the scope of the agency or employment, made during the existence of this relationship." Although the statements made by the employees of Food Lion, while they were being filmed undercover, were statements made during the existence of their employment relationship with Food Lion, the Court finds that Plaintiffs have failed to offer any evidence that demonstrates that the statements, made by the Food Lion employees 'while being filmed undercover, concerned a matter within the scope of their agency. See precision Piping and Instruments, Inc. v. E.I. du Pont de Nemours and Co., 951 F.2d 613, 620 (4th Cir. 1991) (finding that district court correctly refused to admit as a party admission an employee's statements concerning the termination of a contractor because the plaintiff failed to show that hiring and firing of

contractors was within the scope of the employee's employment such that any statements made about hiring and firing were also within the scope of the employee's employment). As a result, because the Plaintiffs have offered no evidence from which this Court can determine the scope of employment of the then current employees of Food Lion who were filmed undercover, the Court finds that the statements made by Food Lion employees while being filmed undercover are not admissible as admissions by a party opponent.

Plaintiffs further contend that these same statements made by Food Lion employees while being filmed undercover are also admissible under Rule 803(1) (present sense impression),fn13 Rule 803(2) (excited utterance),fn14 or Rule 803(3) (state of mind) fn15 of the Federal Rules of Evidence. Plaintiffs have identified only one statement, made by a then current employee while being filmed undercover, which Plaintiffs contend falls within these exceptions. (See Pls.' Resp. to Defs.' Supp. Mem. on the Admiss. of PTL at 7 n.8.) This statement is by a deli employee of Food Lion in which the employee states,

"Well, the floor and the meat slicer—God, coming into a place and the gunk on the slicer is thick. The floor's got all kinds of crap all over it—I don't think it's real appealing for a deli."

(Transcript of PrimeTime Live at 12, attached as Ex. A to Pls.' Resp. to Defs.' Supp. Mem. on Admiss. of PTL. The Court agrees that this statement is excepted from the hearsay rule as a present sense impression because it is a statement describing an event made while the employee was perceiving the event. See Fed. R. Evid. 803(1). However, other than this

one statement on the PTL broadcast, which the Court has set forth above, Plaintiffs do not otherwise identify which statements Plaintiffs contend fall within which exceptions. A party who seeks the admission of hearsay evidence bears the burden of proving each element of the exception he asserts. United States v. Barteiho, 129 F.3d 663, 670 (1st Cir. 1997). Therefore, because Plaintiffs have failed to demonstrate how the remaining statements by the then current employees, while being filmed undercover, fail within Rules 803(1), (2), or (3), the Court finds that the statements of the then current employees, other than the one statements noted by the Court, are inadmissible hearsay.

Next, Plaintiffs argue that statements made by Kim Caudill, who agreed to be interviewed by Diane Sawyer while he was still employed by Food Lion, are also admissible under 801(d)(2)(D) (admission by party opponent - statement by party agent), which the Court has set forth above. However, the Court finds that Kim Caudill's statements are also not admissible as admissions by a party opponent. The Court makes this determination based on the fact that the PTL broadcast specifically states that Kim Caudill agreed to be interviewed in order to "speaks out" against Food Lion. (See Transcript of PrimeTime Live at 5, attached as Ex. A to Pls.' Resp. to Defs.' Supp. Mem. on the Admiss. of PTL.) Plaintiffs have failed to demonstrate how Kim Caudill's statements while "speaking out" against Food Lion are statements made within the scope of his employment. Fed. R. Evid. 801(d)(2)(D); Precision Piping, 951 F.2d at 620. As a result, the Court finds that Kim Caudill's statements are not admissible pursuant to Rule 801(d)(2)(D) as admissions by a party opponent.

Third, Plaintiffs contend that the statements made by former employees who were interviewed on the PTL broadcast are admissible pursuant to Rule 804(b)(3) (statement against interest) of the Federal Rules of Evidence.fn16 The Fourth Circuit has explained that "[a] statement may be admitted under [Rule 804(b)] if the declarant is unavailable; the statement s genuinely adverse to the declarant's . . . interest; and 'corroborating circumstances clearly indicate the trustworthiness of the statement." United States v. Lowe, 65 F.3d 1137, 1145 (4th Cir. *1995),* cert. denied, U.S. . 136 L. Ed. 2d 13 (1996). The party seeking to admit the statement bears the burden of meeting the requirements of Rule 804. Id As a result of this interpretation of Rule 804, to the extent that Plaintiffs contend that the statements made by the former employees are admissible for purposes of the summary judgment motions pursuant to Rule 804(b), the Court finds that Plaintiffs would need to demonstrate that these former employees would be unavailable at trial. However, the Court finds that Plaintiffs have not complied with Rule 804 because Plaintiffs have not offered any evidence that any of these former employees are unavailable as defined by Rule 804(a). Therefore, the Court finds that the statements made by former employees while being interviewed on the PTL broadcast are not admissible pursuant to Rule 804(b)(3).'7

Fourth, Plaintiffs contend that the questions and statements made by Diane Sawyer and the two ABC employees, who went undercover to film the broadcast, are also admissible. in regard to whether questions posed by these declarants are hearsay, this Court relies on United States v. Lewis, 902 F.2d 1176 (5th Cir. 1990). In that case, the Fifth Circuit noted that a statement as defined by the hearsay rule requires that there be either an oral or written

assertion or nonverbal conduct intended as an assertion. Id. at 1179; see Fed. R. Evid. 80 1(a). Based on the fact that the hearsay rule requires the statement to be an assertion, the court found that the questions in that case were not hearsay because they were not intended to assert anything. Lewis, 902 F.2d at 1179. The Court further noted in a footnote that "[e]ven if the questions were 'statements' within Rule 80 1(a), they would not be hearsay because they were not offered to prove the truth of the matter asserted." Id. at 1179 n.2 (quoting Fed. R. Evid. 801(c)). As a result, to the extent that Diane Sawyer or the two ABC employees have posed any questions on the PTL broadcast, this Court finds that these questions are not hearsay because they are not assertions, as required by Rule 80 1(a), nor are they offered for the truth of the matter asserted, as required by Rule 80 1(c). See also United States v. Vest, 842 F.2d 1319, 1330 (1st Cir.), cert. denied, 488 U.S. 965, 102 L. Ed. 2d 526 (1988) (finding that questions were not hearsay because they were not offered for the truth of the matter asserted). Therefore the questions are admissible. However, to the extent that Diane Sawyer or the two ABC employees make any statements on the PTL broadcast that are not questions, the Court finds that Plaintiffs have failed to show that these statements are not hearsay or are subject to an exception to the hearsay rule. Therefore, the Court finds that these statements are not admissible.

Finally, Plaintiffs contend that pursuant to Rule 1006 (summaries) of the Federal Rules of Evidence,fn18 the entire PTL broadcast is admissible as a summary of the forty hours of undercover footage. However, because the underlying materials upon which the summary is based must be admissible in and of itself, see United States v. Johnson, 594 F.2d 1253, 1255 (9th Cir.), cert. denied sub nom., 444 U.S.

964, 62 L. Ed. 2d 376 (1979), the Court finds unavailing Plaintiffs' argument that Rule 1006 provides an exception to the hearsay rule for the PTL broadcast. As a result, the Court finds that the PTL broadcast is not admissible pursuant to Rule 1006.

The Court notes, however, that even if the entire PTL broadcast is admissible on any grounds, the Court finds that this broadcast still does not present evidence of widespread unsanitary conditions of which Defendants knew. This is so because the PIL footage, as well as the additional forty hours of unedited footage, was filmed at only three of Food Lion's almost 1000 stores. Furthermore, Plaintiffs do not dispute that out of Food Lion's 60,000 active employees and 40,000 former employees, the PTL broadcast and forty hours of unedited footage only interview a total of seventy current and former employees, twenty-two of whom had left the employ of Food Lion as much as eight years before the beginning of the Class Period. seventy Food Lion's Mem. in Supp. of Mot. for Summ. J. at 6; Pls.' Mem. in Opp'n to Food Lion's Mot. for Summ. J. at 4.) Other than these seventy current and former employees who were mentioned on the PTL broadcast, Plaintiffs have not come forward with any other statements of current or former employees who claim that Food Lion had unsanitary conditions during the Class Period.fn19 As a result, the Court finds that, with respect to the sanitary conditions at Food Lion's 1000 stores, the PTL broadcast is insufficient to draw any conclusions about Food Lion's operations as a whole. fn20

Next, in support of Plaintiffs' contention that Defendants were aware of widespread unsanitary conditions in Food Lion stores, Plaintiffs offer statements made by

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Secretary of Labor Robert Reich in a DOL news release following the DOL-Food Lion settlement. (Pls' Ex. 44.) Plaintiffs argue that these statements further confirm much of the PTL broadcast regarding employees working off the clock which inevitably led to the non-observance of formal sanitary policies. (Pls.' Mem. in Opp'n to Food Lion's Mot. for Summ. J. at 2, 9.) Initially, the Court notes that these statements are inadmissible hearsay and that Rule 803(8) (public records exception)fn21 of the Federal Rules of Evidence does not except these statements from the hearsay rule. This is so because the press release was simply an announcement that a settlement agreement had been executed between Food Lion and the DOL. The press release was not an investigatory report adopted by the DOL nor did the press release contain any findings, opinions, or conclusions based on a factual investigation as contemplated by the public records exception. Beech Aircraft Corp. v. Rainey, 488

U.S. 153, 170, 102 L. Ed. 2d 445, 463 (1988) (finding that portions of investigatory reports containing conclusions and opinions based on a factual investigation should not be excluded simply because the reports contain these conclusions and opinions); see also Distaff, Inc. v. Springfield Contracting Corp., 984 F.2d 108, 109.11 (4th Cir. 1993) (reviewing whether an investigative report that contains an opinion of the investigator, concerning the cause of a fire, is admissible under the public records exception). However, even if Secretary Reich's statements in this press release are admissible, the Court finds that these statements are not probative on the question of whether Defendants knew about widespread sanitation problems. This is so because Secretary Reich only made statements about Food Lion's settlement of labor claims arising from employees working off the clock. Secretary Reich did not make any

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conclusion based upon investigatory findings that any labor violations resulted in widespread unsanitary conditions at Food Lion stores. More importantly, there is not any discussion of sanitation problems at Food Lion in Secretary Reich's press release. Thus, Secretary Reich's statements are not relevant to the issue of whether Food Lion was aware of widespread unsanitary practices throughout Food Lion stores as Plaintiffs contend.

Plaintiffs also offer the "Simonsen Letter" (Pls.' Ex. A., attached to Pls.' Resp. to Defs.' Supp. Mem. on Admiss. of Simonsen Letter) as evidence that Defendants were aware that Food Lion had widespread sanitation problems throughout its stores. The Simonsen Letter is a correspondence from David R. Simonsen, Jr., Esq., to Vice President of Human Resources David R. McKinley, in which Simonsen not only expresses his thoughts and concerns about Food Lion employees working off the clock, but Simonsen also makes statements regarding what Food Lion supervisors had told him about employees working off the clock. Again, before addressing what is disclosed in the Simonsen Letter, however, the Court must first address whether this letter is admissible.

Although Defendants contend that the whole letter is inadmissible hearsay, Plaintiffs contend that the letter is admissible pursuant to Federal Rule of Evidence 801(d)(2)(C) (admission by a party opponent statement by a person authorized to make a statement).fn22 In this regard, Plaintiffs have offered evidence of a document wherein Tom Smith has authorized David R. Simonsen, Jr., Esq., to act as his representative in dealing with the DOL. (Pls.' Ex. B, attached to Pls.' Resp. to Defs.' Supp. Mem. on Admiss. of Simonsen Letter.) Plaintiffs have also offered an affidavit of

Simonsen wherein Simonsen states that in July and August of 1990, one of his assignments "was to provide legal counsel and advice with respect to employment matters, including legal issues arising with respect to so called 'working off the clock' matters." (Pls.' Ex. C., attached to Pls.' Resp. to Defs.' Mem. on Admiss. of Simonsen Letter.) Furthermore, Plaintiffs have offered an affidavit of Eugene R. McKinley, Vice President of Human Resources, who states that he hired Simonsen for the purpose of ensuring the company's compliance with federal wage and hour laws related to working off the clock. (Pls.' Ex. D, attached to Pls.' Resp. to Defs.' Supp. Mem. on the Admiss. of Simonsen Letter.) Thus, the Court finds that Plaintiffs have offered sufficient proof that Simonsen was authorized to make statements concerning employees working off the clock such that the Simonsen Letter is admissible pursuant to Rule 801(d)(2)(C).

However, even to the extent that the Simonsen Letter is admissible, the Court again finds, after a thorough review of this letter, that the Simonsen Letter does not support Plaintiffs' contention that Food Lion was aware of widespread sanitation problems as a result of the Effective Scheduling System The Court finds that there is no mention of unsanitary conditions in this letter nor is any connection made that the Effective Scheduling System was causing any sanitation problems. Therefore, the Court finds that the Simonsen Letter, to the extent that there is no reference to the sanitation issue, does not offer any evidence which would enable this Court to draw any conclusions about Food Lion's sanitary conditions throughout its stores.

In addition to PTL, Secretary Reich's statements, and the Simonsen Letter, Plaintiffs have also offered several Food Lion memoranda that Plaintiffs contend also reveal

unsanitary conditions during the Class Period. The Court notes, however, that each of these memos is Food Lion's attempt to respond to the workplace error once Food Lion became aware of it. For example, Plaintiffs have offered a May 28, 1990 letter from an employee at one store who claimed that there was "gunk" in a chicken fryer and that "Pat" was using old chicken. (Pls.' Ex. 9.) Tom Smith, however, replied that the problem would be taken care of. (Id.) In June of 1990, Food Lion issued a sanitation task force report. (Pls.' Ex. 8.) Although the report says that "[o]ur sanitation in many areas is just not up to standard" and that "[s]anitation starts with clean, well groomed, neat employees," the report further states that "[w]e will be looking at this area very closely." (Id.) Finally, another illustration of what Plaintiffs contend demonstrates poor sanitation in Food Lion stores is the clock such that the Simonsen Letter is admissible pursuant to Rule 801(d)(2)(C).

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Furthermore, Plaintiffs have offered two additional memos that they contend also demonstrate that, during the Class Period, Defendants knew about poor sanitation and food handling practices throughout its stores—(1) a

November 16, 1992 memo to Blake Bolick, who was the Regional Human Resources Supervisor in Food Lion's Human Resources Department and who supervised field investigations made by many of Food Lion's Regional Human Resources Managers, which stated that out-of-date merchandise had been found in 18 stores, and (2) a November 18, 1992 memo to Food Lion Vice Presidents from Vincent G. Watkins, Vice President of Special Projects and Development, stating that Food Lion would no longer offer products at a reduced price after the manufacturer's sell-by date.fn23 (Pls.' Exs. 6 & 7.) The Court notes, however, that these documents were generated after the Class Period. As a result, these documents also were generated after any of Defendants' statements in Food Lion's Annual and Quarterly Reports which Plaintiffs contend left out material information. Therefore, the Court finds that these post Class Period memos also do not support Plaintiffs' contention that Defendants knew about widespread poor sanitation at Food Lion stores during the Class Period but omitted to disclose this material information in its Annual and Quarterly Reports. See Kas v. First Union Corp., 857 F. Supp. 481, 488 (E.D. Va. 1994) ("It is well-settled that 'fraud by hindsight' is not actionable under Section 10b or Rule 10b-5.").

Finally, Plaintiffs contend that their expert report by Dr. Sidney Gilbreath, *(see* Pls.' Ex. 15), also is evidence that demonstrates that Food Lion's Effective Scheduling System caused employees to engage in unsanitary practices throughout Food Lion stores. In this report, Dr. Gilbreath gives his opinion of the effect of the Effective Scheduling System as it is implemented at Food Lion. Dr. Gilbreath explains that during the Class Period, the time Food Lion has allocated for employees to complete tasks under Food Lion's Effective Scheduling System was based on an average time

that it took employees to complete these tasks. Furthermore, Dr. Gilbreath gives his opinion that because store managers were evaluated based on their ability to effectively implement the Effective Scheduling System, this had the potential to cause Food Lion managers to engage in the following practices:

> (1) Understaff intentionally for projected workloads.
> (2) Pressure employees to work harder, beyond the range of reasonable expectation.
> (3) Juggle actual labor hours among departments,
> (4) Overstate bases for variable labor-hour requirement calculations.
> (5) Pressure employees to skip breaks.
> (6) Ignore and/or participate in and/or require working "off the clock."
> (7) Minimize time spent on certain necessary but not-urgent "fixed" tasks to provide more labor hours to complete necessary and urgent "variable" work requirements.
> (8) Misapply allowed indirect hours.
> (9) Engage in combinations of these manipulative practices to enable weekly reporting for each store department of no more actual labor hours than "allowed" by the ES system.

(Pls.' Ex. 15 at 1.) Thus, Plaintiffs contend that Dr. Gilbreath's expert report demonstrates that, inter alia, the Effective Scheduling System was causing employees to minimize the time spent on certain fixed tasks, such as cleaning, in order to complete necessary and urgent work requirements. (Pls.' Mem. of Law in Opp'n to Food Lion's Mot. for Summ. J. at 7-8.) However, based on Plaintiffs'

failure to provide any other evidence of widespread sanitation problems resulting from Food Lion's Effective Scheduling System, the Court finds that Dr. Gilbreath's report, in and of itself, is insufficient to raise a genuine issue of material fact concerning whether there were widespread sanitation problems at Food Lion stores. As a result, the Court declines to accept Dr. Gilbreath's report as evidence that Food Lion had widespread sanitation problems throughout its stores. See In re Apple Computer Sec. Litig., 886 F.2d 1109, 1116 (9th Cir. 1989), cert. denied sub nom., 496 U.S. *943*, 110 S. Ct. *3229*, 110 L. Ed. 2d 676 (1990) (finding that the court is not required to accept an expert report in the face of otherwise contrary evidence).

Consequently, the Court finds that based on the evidence presented, Plaintiffs have failed to demonstrate that there is a genuine issue of material fact that Food Lion was aware of widespread poor sanitation practices throughout its 1000 stores as a result of its Effective Scheduling System. Rather, the evidence merely demonstrates that at the most, Defendants were aware only of isolated instances of workplace errors which Food Lion took steps to remedy when they were brought to Defendants' attention. Therefore, the Court finds that there was no omission about widespread sanitation problems in Food Lion stores that, as Plaintiffs contend, Defendants had a duty to disclose.

b. The Isolated Instances of Workplace Errors

The question then remains whether the isolated instances of workplace misconduct that Plaintiffs have relied upon are material facts that Defendants had a duty to disclose. The Court resolves this question by reference to the case of In re Union Carbide Class Action Sec. Litig., 648 F.

Supp. 1322 (S.D.N.Y. 1986). In re Union Carbide is a securities fraud case that arose out of a gas leak at Union Carbide's Bhopal industrial plant. Plaintiffs in that case alleged that Union Carbide failed to disclose, inter alia, that its safety systems and procedures were inadequate to safely store and manufacture dangerous chemicals in its Bhopal Plant. Id. at 1324. Plaintiffs argued that this omission caused the statement made in Union Carbide's Annual Report, that "Union Carbide's expertise gives it *exceptional qualifications for meeting rough environmental and safety standards associated with agricultural chemicals,*" to be misleading because Union Carbide knew of safety defects in its Bhopal Plant that affected the ability of the plant to meet environmental and safety standards. Id. at 1326, 1328. However, despite the defendant's knowledge of these defects, the district court held that the statements concerning the company's environmental and safety qualifications were not misleading because the company was taking steps to remedy the defects about which it knew. Id. at 1328. As a result, the district court dismissed the securities fraud claim on the grounds that any alleged omission could not make the affirmative statement in defendant's annual report misleading. Id. The district court noted that a holding of liability in this case "would constitute an overly expansive reading of the federal securities laws, and might encourage corporations to disclose trivial information not necessary for informed decisionmaking." Id.

Similarly, to the extent that there are any isolated instances of workplace errors, the Court finds that not only is there not a substantial likelihood that the reasonable investor would consider the limited instances of workplace errors important in deciding whether to purchase Food Lion securities, see Andrews v. Fitzgerald, 823 F. Supp. 356, 370

(M.D.N.C. 1993), but the Court also finds, as previously stated, that Defendants were taking steps to remedy these isolated problems. *See* In re Union Carbide, 648 F. Supp. at 1328. As a result, the Court finds that to the extent that there is any omission by Defendants in their Annual and Quarterly Reports of isolated instances of workplace errors, this omission not only is not material as required by § 10(b) but also could not make any affirmative statements misleading in Defendants' Annual and Quarterly Reports.

Thus, to the extent that Plaintiffs allege that Food Lion failed to disclose what Plaintiffs contend were widespread, poor sanitation practices throughout its stores as a result of the Effective Scheduling System, the Court finds that the evidence before this Court fails to demonstrate that Defendants were aware of any widespread sanitation problems. Rather, the evidence merely shows isolated instances of workplace errors. The Court finds that any alleged omission of the isolated instances of workplace errors is not a material omission as a matter of law. Hilison Partners, 42 F.3d at 209; Andrews, 823 F. Supp. at 370. Therefore, the Court will grant Defendants' motions for summary judgment as to Plaintiffs' claim that Defendants' statements in its Annual and Quarterly Reports omitted material matters about unsanitary conditions.

2. Justifiable Reliancefn24 and Disclosure of the Alleged Labor Violations As previously explained, Plaintiffs contend that Defendants made statements in Food Lion' Annual and Quarterly Reports about Food Lion's high regard for good sanitation and Food Lion's higher than industry profit margins, but that Defendants omitted from these statements, (1) that Food Lion's Effective Scheduling System caused employees to engage in unsanitary practices in order

to avoid working off the clock and (2) that Food Lion's profit margins were based on illegal labor practices attributable to the Effective Scheduling System. Under the first prong of the prima facie case (omission of material fact), the Court has found that any omission concerning isolated instances of workplace errors is not material as a matter of law and that, as a result, this alleged omission is not actionable for purposes of this securities fraud claim.

As to the alleged omission that Food Lion's profit margins were based on illegal labor practices, Defendants deny that its profit margins were attributable to violations of the FLSA. Defendants argue that to the extent that employees accused Food Lion of violating the FLSA, Defendants contend that the employee accusations were disclosed as of September 11, 1991. As a result, Defendants have moved for summary judgment claiming that because this alleged omission was fully disclosed as of September 11, 1991, Plaintiffs who purchased stock after this date are unable to establish the justifiable reliance element of Plaintiffs' prima facie case. Defendants have also moved for summary judgment as to those Plaintiffs who purchased Food Lion stock prior to September 11, 1991 claiming that these Plaintiffs are barred by the one-year statute of limitations. The Court will discuss in turn the issues of justifiable reliance as to the post-September 11, 1991 shareholders and the application of the statute of limitations as to the pre-September 11, 1991 shareholders.

a. The Fraud on the Market Theory

Plaintiffs seek to establish justifiable reliance by use of the "fraud on the market" theory. When a plaintiff pursues

a claim based on the "fraud on the market" theory, a plaintiff is not required to prove direct reliance. "It is presumed that a materially false or misleading statement regarding a company or its business defrauded purchasers of the company's stock even if they did not directly rely on the statement because they relied instead on the integrity of the price set by the market." Malone v. Microdyne Corp., 26 F.3d 471, 476 n.5 (4th Cir. 1994) (citing Basic. Inc., 485 U.S. at 24 1-50, 108 S. Ct. at 98 8-93, 99 L. Ed. 2d 194 (1983)). On the other hand, however, "the presumption that the market price has internalized all publicly available information cuts both ways." Raab v. General Physics Corp., 4 F.3d 286, 289 (4th Cir. 1993). Thus, "in a fraud on the market case, the defendant's failure to disclose material information may be excused where that information has been made credibly available to the market by other sources." Id (quoting In re Apple Computer, 886 F.2d at 1115). In order for full disclosure to be sufficient to avoid liability under § 10(b) and Rule 10b-5 "any material information which insiders fail to disclose must be transmitted to the public with a degree of intensity and credibility sufficient to effectively counterbalance any misleading impression created by insiders' one-sided representations." In re Apple Computer, 886 F.2d at 1116 (citing Basic, Inc., 485 U.S. 224, 108 S. Ct. 978, 99 L. Ed. 2d 194).

As previously stated, Defendants contend that, as of September 11, 1991, there was full disclosure of the employee accusations that Food Lion was in violation of the FLSA. Defendants further contend that because there was disclosure, Plaintiffs cannot establish justifiable reliance on any allegedly artificial stock price set by the market as a result of Defendants' statements in its Annual and Quarterly Reports concerning Food Lion's higher than industry profit

margins. Conversely, Plaintiffs contend that any disclosure concerning accusations by Food Lion employees that Food Lion's profit margins were attributable to employees working off the clock was not sufficient to inform the market of the labor violations. In order to address this issue, this Court relies on Raab v. General Physics Corporation. In Raab, the Fourth Circuit addressed whether statements made in General Physics Corporation's 1991 Annual Report were materially misleading because the statements failed to disclose the adverse impact of a slowdown in contracting awards on first quarter 1992 earnings and on the company's predictions of growth in the market. 4 F.3d at 289. The court held that the omission of the contracting slowdown from the Annual Report was not actionable because the defendant company had contemporaneously informed the market of the same fact in a press release. id. As the Raab court stated, "[t]he 'other source' in this case [in addition to the 1991 Annual Report] was the press release; if the contracting slowdown was material, the market was aware of it, and the price of shares reflected it." Id.

In the present case, the following information was available to the market through press releases and through Food Lion's Annual and Quarterly Reports. In a September 11, 1991 press release, the United Food and Commercial Workers Union ("UFCW") disclosed that it had filed a complaint with the DOL alleging that Food Lion had engaged in at least 183 cases of off the clock work. (Defs.' Ex. C.) This press release further disclosed that 64.6 million dollars was a "conservative estimate" of the amount of Food Lion's profits that were attributable to off the clock labor violations and that more than thirty-seven percent of Food Lion's net profits were derived from violations of federal wage and hour laws. (Id.) The UFCW press release further disclosed that

Food Lion could potentially face up to 194 million dollars in back wages and that its liability could be as high as 388 million dollars. (Id.) Finally, the UFCW press release disclosed that it is Food Lion's Effective Scheduling System that is "'the engine that drives the vast majority of all off the clock work at Food Lion."(PTL) In addition to the UFCW press release, other press releases by United Press International, Reuters, PR Newswire Assoc. Inc., Bureau of National Affairs. Inc., The Washington Post, Supermarket News, and Business Week repeatedly disclosed this same information. (Exs. A-H, attached to Norwood Deli.) These publications are the type of publications upon which analysts covering supermarket stocks typically rely. (Norwood Decl. ¶ 2; Wilder Decl. ¶ 2.) It further appears that analysts were aware of the UFCW's allegations and noted the effect of the allegations on the price of Food Lion's stock. (See Norwood Decl. ¶ 4; Wilder Aff. ¶¶ 4.5.)

In addition to the disclosures about the allegations about Food Lion's labor violations in these press releases, Food Lion itself made these disclosures in the same Annual and Quarterly Reports on which Plaintiffs now rely to establish its allegations that Food Lion omitted material facts. For example, Food Lion disclosed in its Quarterly Report for the period ending September 7, 1991 that the UFCW had filed a complaint with the DOL which alleged that Food Lion engaged in "(a) repeated and willful failure to pay hourly employees overtime compensation in violation of the FLSA., (b) willful discrimination and retaliation against employees who attempt to exercise their rights under the FLSA, and (c) willful falsification and alteration of employees' time records and failure to keep proper and required time records, in violation of the FLSA." (Ex. K at 8a, attached to Norwood

Decl.; McCanless Aff. at 6 n.1.) In Food Lion's Annual Report for the fiscal year ending December 28, 1991, which was filed with the Securities Exchange Commission ("SEC") on March 27, 1992, Food Lion again repeated the information it had disclosed in its prior Quarterly Report and added that the DOL had decided to conduct an investigation into the alleged violations. (McCanless Aff. at 7-8 n.3.) Food Lion further disclosed that the UFCW had filed a Supplemental Complaint which added fifty-five additional claims of off the clock violations. (Id.) Also in this Annual Report, Food Lion disclosed that additional complaints had been filed by individual employees as well, who were not represented by the UFCW, all of whom were alleging labor violations. (Id. at 10-12 n.4.)

Other evidence of disclosure appears in Food Lion's Quarterly Report for the quarter ending March 21, 1992, which was filed with the SEC around May 4, 1992. In this report, Food Lion disclosed additional individual employee complaints alleging labor violations. (Id. at 13-14 n.5.) Food Lion's Quarterly Report for the fiscal quarter ending June 13, 1992, which was filed with the SEC on July 24, 1992, also disclosed that the UFCW had filed a Second Supplemental Complaint which added fifty-two additional claims of labor violations, (id. at 7-8 n.3), and that even more individual employee complaints had been filed. (Id. at 15-16 n.6.) Finally, in Food Lion's Annual Report for the fiscal year ending September 5, 1992, Food Lion again disclosed additional individual complaints. (Id. at 17 n.7; Ex. I at 9b, attached to Norwood Deli.)

Plaintiffs contend that even though Defendants made disclosures about the allegations by the UFCW and the numerous employees that the Effective Scheduling System

caused employees to work off the clock, Defendants still did not fully disclose whether Food Lion was in fact engaging in violations of the FLSA. Plaintiffs' position is that it was not until the PTL broadcast that the public, and the market, received unbiased news concerning the facts of Food Lion's violations. However, the Court finds that even though Defendants did not admit, as Plaintiffs would have them do, that labor violations were occurring, Defendants did in fact disclose the risk that Food Lion could potentially be found liable based on the employee allegations of working off the clock. For example, in Food Lion's Quarterly Report for the quarter ending September 7, 1991, Defendants disclosed that:

> "Management and legal counsel for the Company are currently investigating and evaluating the allegations contained in the Complaint. The ultimate liability, if any, which may result is not presently determinable; however, in the opinion of management, any liability will not have a material adverse affect on the financial condition of the Company. Management believes that the Company has meritorious defenses to the allegations and the Company intends to defend the allegations vigorously."

(McCanless Aff. at 6 n.1.) Food Lion continued to make these same or similar disclosures in its Annual and Quarterly Reports throughout the Class Period. at 6.17, 19 n. 1, 3-8.) Furthermore, in Food Lion's Quarterly Report for the quarter ending September 5, 1992, Food Lion made the following disclosure:

> "The Department of Labor has advised the Company that its investigation has disclosed what it terms 'substantial' overtime and child labor violations. The

> ultimate liability, if any, which may result is not presently determinable because, among other reasons, the Department of Labor has not fully disclosed to the Company the results of its investigation; however, in the opinion of the Company, the Company has meritorious defenses to the allegations and the Company intends to defend the allegations vigorously. Based on currently available information, any liability will not have a material adverse affect [sic] on the financial conditions or results of operations of the Company."

(Id. at 9 n.3.)

> In order to address Plaintiffs' contention that Defendants did not fully disclose the

facts concerning the alleged labor violations, the Court relies on In re Apple Computer. In that case, the Ninth Circuit specifically addressed whether optimistic statements concerning the defendant company's "Lisa" computer where shielded from liability because of the press' documentation of the relevant risks associated with the computer. 886 F.2d at 1115. The court noted that, in order to address this question, the issue with regard to the defendant company's misstatements was whether "in light of the press' documentation of Lisa's risks, a rational jury could nonetheless find a 'substantial likelihood' that full disclosures [by the defendant company] would have 'significantly altered the total mix of information made available." Id. at 1115 (quoting TSC Indus., 426 U.S. at 449 96 S. Ct. at 2132, 48 L. Ed. 2d at 757). The court found that because at least twenty articles portrayed Lisa as a gamble with the potential of either success or failure, the market

could not have been more aware of Lisa's risks. Id. at 1116. As a result, the court found that stock's price reflected the information concerning the risks associated with the Lisa computer and that plaintiffs could not establish justifiable reliance on any allegedly artificial stock price set by the market from the defendant company's optimistic statements. See id. at 1119, 1116.

Similarly, based on the evidence before this Court, the Court finds that the numerous press releases beginning September 11, 1991, as well as Food Lion's continued disclosure of employee allegations of labor violations in the same Annual and Quarterly Reports which Plaintiffs contend omitted this sane information, informed the market of the potential risks associated with the employee allegations of working off the clock in violation of the FLSA. The Court finds that the market was repeatedly made aware that Food Lion was facing numerous employee complaints of working off the clock as a result of the Effective Scheduling System and that thirty-seven percent of Food Lion's profits possibly were attributable to employees working off the clock. In the face of the substantial disclosure of the risks that Food Lion faced based upon the allegations of labor violations, the Court finds that any further disclosure about the specifics of Food Lion's questioned labor practices would not be material as a matter of law. This finding takes into account the fact of Food Lion's denial that illegal labor practices were taking place within its stores. In light of the information that was disclosed, the Court finds that there is not a substantial likelihood that a rational jury could find that requiring Food Lion to admit an allegation of labor violations would have significantly altered the total mix of information available to the market when the market was repeatedly made aware of the risk that Food Lion could be found liable as a result of the

employee complaints. See id. at 1115. Therefore, because Food Lion's Annual and Quarterly Reports throughout the Class Period (1) revealed the allegations by employees that Food Lion's Effective Scheduling System caused employees to work off the clock and that thirty-seven percent of Food Lion's profits were attributable to employees working off the clock, and (2) revealed the risk that Food Lion could be found liable for the alleged labor violations, the Court finds that all material information allegedly tending to undermine Food Lion's optimistic statements in its Annual and Quarterly Reports about its higher than industry profit margins credibly entered the market as of September 11, 1991. Consequently, the Court finds that the price of Food Lion stock reflected the facts allegedly omitted by Defendants such that Plaintiffs are unable to establish justifiable reliance on what Plaintiffs contend was an artificial stock price set by the market as a result of Food Lion's optimistic statements concerning its higher than industry profit margins.

Nonetheless, Plaintiffs further argue that because the market did not fully react until after the airing of the PTL broadcast, this demonstrates that there was not full disclosure sufficient to inform the market until the PIL broadcast on November 5, 1992. (Pls.' Mem. in Opp'n to Food Lion's Mot. for Summ. J. at 12.) This Court, however, is not persuaded by this argument and notes that the court in In re Apple Computer specifically addressed this issue. 886 F.2d at 1116. In that case, plaintiffs argued that summary judgment was not appropriate because the evidence of dramatic stock price movements in response to the defendant company's optimistic statements demonstrated that the information about the Lisa computer's risks were not credibly disclosed. Id. The court stated that

> [d]ramatic price movements in response to an optimistic statement would provide a strong indication that the statement itself was material, but would not suggest that material information tending to undermine the statement has not been made available to the market. An entirely plausible explanation would be that the market was persuaded by [the defendant company's] optimism notwithstanding the known risks. But the evidence of stock price movements provides no rational basis for determining whether.. risks were adequately conveyed to the public.

Id (citation omitted). Based on this rationale, this Court finds that the fact that the stock price may have significantly moved as a result of the PTL broadcast, but did not so dramatically move upon the disclosure on September 11, 1991 of the UFCW and individual employees' complaints, as Plaintiffs contend, is not dispositive of whether the information about Food Lion's potential labor violations was adequately conveyed to the public beginning September 11, 1991.

As a result, the Court finds that information concerning the allegations that Food Lion employees were forced to work off the clock as a result of the Effective Scheduling System, information concerning the DOL investigation of employee allegations of unpaid overtime, and information concerning the possible effects of these labor violations on Food Lion's net profits was all made credibly available to the market through numerous press releases and through Food Lion's Annual and Quarterly Reports beginning on September 11, 1991. Furthermore, the Court finds that the fact that Defendants did not make any'

statements of admission, as Plaintiffs would have them to do, concerning these allegations is not material as a matter of law because, particularly in light of Defendants' denial, such admissions would not have changed the total mix of information available to the market. Consequently, the Court finds that the price of Food Lion's stock as of September 11, 1991 reflected the risk associated with the allegations of Food Lion's labor violations, even though Plaintiffs contend that this information was omitted from the disclosures previously made by Food Lion. Therefore, as to those Plaintiffs who purchased Food Lion stock as of September 11, 1991, the Court finds that Plaintiffs are unable to establish that those Plaintiffs justifiably relied on an artificial stock price set by the market as a result of Food Lion's optimistic statements concerning its higher than industry profit margins. The Court will grant Defendants' motions for summary judgment as to those Plaintiffs who purchased Food Lion stock as of September 11, 1991.

b. Statute of Limitations

Defendants further contend that they are entitled to summary judgment as to those Plaintiffs who purchased Food Lion stock prior to September 11, 1991, before the market learned of the allegations of illegal labor practices by Food Lion. All of the Plaintiffs in the class, including those who purchased Food Lion stock prior to September 11, 1991, filed this present civil action either on November 12, 1992 (the Longman Complaint) or November 13, 1992 (the Feinman Complaint). Therefore, Defendants argue that because those members of the class who purchased Food Lion stock prior to September 11, 1991 did not file within one year of disclosure, they are time barred. In Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, *501* U.S. 350, 111 S. Ct. 2773, 115 L.

Ed. 2d 321 (1991), the Supreme Court established that claims brought under § 10(b) and Rule 10b-5 must be commenced within one year of the discovery of the violation but not more than three years after the violation. See Coolie, 998 F.2d at 1264 (citing Lampf); see also Andrews, 823 F. Supp. at 365 (acknowledging that actions brought after Lampf apply the one-year/three-year statute of limitations). The doctrine of equitable tolling does not apply. Cooke, 998 F.2d at 1264. The Fourth Circuit has determined that the statute of limitations for securities fraud begins to run "'when the fraud is either actually known or should have been discovered by the exercise of due diligence." Andrews, 823 F. Supp. at 365 (quoting Newman v. Prior, 518 F.2d 97, 100 (4th Cir. 1975)). In a fraud on the market case, the statute of limitations begins to run when the market knew or could have discovered the alleged fraud in connection with the securities sale. See Cooke, 998 F2d at 1262-63. Furthermore, as the Fourth Circuit has explained,

> [i]nquiry notice is triggered by evidence of the possibility of fraud, not by complete exposure to the alleged scam. Merely bringing suit after the scheme has been laid bare through the efforts of others. will not satisfy the requirements of due diligence when there have been made prior warnings that something was amiss.

Brumbaugh v. Princeton Partners, 985 F.2d 157, 162 (4th Cir. 1993).

Plaintiffs filed both lawsuits now before this Court one week after the November 5, 1992 PTL broadcast. Plaintiffs allege that PTL revealed that Food Lion's time management system called Effective Scheduling forced employees to work off the

clock. (Am. Compl. ¶ 27.) Plaintiffs further allege that the PTL broadcast revealed that the DOL was investigating Food Lion's labor practices regarding its off the clock work requirements. (Am. Compl. ¶ 28.) Because the Court has found that information concerning working off the clock as a result of the Effective Scheduling System, the DOL investigation, and the possible effects of labor violations on Food Lion's net profits was made credibly available to the market beginning September 11, 1991, the Court also finds that the statute of limitations for bringing any legal action relating to this information began running on that date. See Cooke, 998 F.2d at 1263 (finding that the date on which the market was apprised of the information was also the date on which the statute of limitations commenced running). Thus, to the extent that the statute of limitations began running on September 11, 1991, and because the Longman Complaint was not filed until November 12, 1992 and the Feinman Complaint was not filed until November 13, 1992, those Plaintiffs who purchased Food Lion stock prior to September 11, 1991 are barred by the one-year statute of limitations. The Court will grant Defendants' motions for summary judgment as to those 7laintiffs who purchased Food Lion stock prior to September 11, 1991.

3. Scienter

Notwithstanding the Court's consideration of the previous issues, Defendants argue that they are nevertheless entitled to summary judgment on the § 10(b) and Rule 10b-5 claims because Plaintiffs are unable to prove that any alleged omissions were made with scienter. Scienter is defined as "a mental state embracing intent to deceive, manipulate, or defraud." Malone, 26 F.3d at 478 (quoting Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194 n.12, 96 S. Ct. 1375, 138 1-82

n.12, 47 L. Ed. 2d 668, 677 n.12 (1976)). Severe recklessness may also satisfy the scienter requirement. Simpson v. Specialty Retail Concepts, Inc., 908 F. Supp. 323, 328 (M.D.N.C. 1995); see Malone, 26 F.3d at 479 n.9 (stating that "[m]ost circuits have held that recklessness also may satisfy the scienter requirement"). Just as with the question of materiality, "issues of intent typically go to the jury and defendants are not entitled to summary judgment as a matter of law on the ground of lack of scienter unless the plaintiff has failed to present facts that can support an inference that defendants acted 'with an intent to deceive,' manipulate, or defraud." Malone, 26 F.3d at 479 (quoting Wechsler v. Steinberg, 733 F.2d 1054, 1058-59 (2nd Cir. 1984)).

The Court will address the issue of scienter in light of what Plaintiffs contend were the two omissions from Food Lion's Annual and Quarterly Reports—that is, (a) Defendants made statements about Food Lion's higher than industry profit margins but did not disclose that its profit margins were based on illegal labor practices which were attributable to its Effective Scheduling System, and (b) Defendants made statements about Food Lion's high regard for good sanitation but did not disclose that its Effective Scheduling System caused employees to engage in unsanitary practices in order to avoid having to work off the clock. The Court notes that Defendants deny Plaintiffs' contentions that Food Lion engaged in illegal labor practices and had unsanitary conditions as a result of the demands of the Effective Scheduling System.

a. Scienter With Respect To Working Off The Clock

Defendants contend that there is insufficient evidence to create a genuine issue of material fact with respect to scienter from which a reasonable jury could infer that Defendants acted with the intent to defraud, or acted with severe recklessness, by not disclosing, as Plaintiffs contend, Defendants' knowledge that employees were working off the clock as a result of the Effective Scheduling System. Conversely, Plaintiffs argue that the August 2, 1990 Simonsen Letter clearly shows that Defendants were aware of violations of the FLSA as a result of the Effective Scheduling System; Plaintiffs further contend that Defendants acted with an intent to defraud the market, or acted with severe recklessness, by not disclosing Defendants' knowledge of the effect of Food Lion's Effective Scheduling System. At the February 18, 1998 hearing, Plaintiffs submitted the following statements from the Simonsen Letter which Plaintiffs contend support their argument that Defendants acted with scienter:

> (1) One general area of concern of the supervisors is the perceived harshness with which management has reacted to particular rules violations.
>
> (2) Another general area of concern is how recent management actions will affect our compliance with the rule against working off the clock. On the one hand, supervision believes that our current compliance with the rule [against working off the clock] is excellent and the best it has ever been. On the other hand, however, supervision believes that recent developments will result in a significant amount of working off the clock.
>
> *(3)* Two developments to which supervision points are the improved audit of product entering the stores

> (thus, decreasing the ability of department management to cheat on the case counts).
>
> (4) One supervisor put it this way: "Every one in this room does everything he can to stop working off the clock. The amount of working off the clock now is the smallest it's ever been or will be. But, with these kinds of requirements, department heads will have one of three choices: cheat on effective scheduling as best they can; work off the clock as best they can; or get fired."
>
> (5) We have discussed the making of a videotape with Tom Smith addressing the problem of working off the clock. Given the current attitudes of supervision and department heads, I fear that any such additional efforts at communicating the rule against working off the clock, without a perceived reduction in production pressure, would be very cynically received.

(Pls.' Ex. A, attached to Pls.' Resp. to Defs.' Supp. Mem. on Admiss. of Simonsen Letter.) However, even viewing this letter in its entirety, the Court finds that this letter only reflects Simonsen's recollection as to the supervisors assumptions or observations as to employees working off the clock. After reviewing the Simonsen Letter, the Court finds that the Simonsen Letter is not evidence from which a reasonable jury could infer that Defendants intended to deceive the market See Malone 26 F.3d at 479.

Furthermore, the Court also finds that a consideration of the other evidence before this Court fails to reveal an intent to defraud on behalf of Defendants. For example, Defendants' evidence shows that whether it is called

"effective scheduling," "demand scheduling," or "target scheduling," Food Lion is not the only store that employs a labor scheduling system where work is monitored according to a given amount of time. (Dawson Aff. ¶ 4; Vedeikis ¶ 7.) Furthermore, Defendants offered evidence that Food Lion is better at monitoring off the clock violations than some of its competitors. (Bolick ¶ 11; Vedeikis ¶ 7.) The evidence also shows that Food Lion has policies in place for ensuring that employees know that working off the clock is prhibited. (Dinse Aff. ¶ 3.) For example, when an employee begins working at Food Lion, the employee goes through an orientation process which includes a review of Food Lion's off the clock policy statement. (Id.) Every year thereafter, the employee must read and sign an acknowledgment of this policy. (Id.) This policy is contained in the Personnel Handbook distributed to each employee. (Id.) Food Lion also has employee hotlines through which employees may anonymously report off the clock violations. (Id. ¶ 4.) Finally, Food Lion conducts anonymous employee surveys in which employees are requested to report off the clock violations. (Id.) If, through any of these means, an off the clock violation is reported, Food Lion conducts an investigation into this allegation. (Vedeikis ¶ 5.) If it is determined that an employee intentionally worked off the clock, that employee is disciplined in accordance with Food Lion policy. (Id.) If it is determined that the employee's supervisor knew about the employee working off the clock but ignored it, the employee is paid for the time and the supervisor is terminated. (Id.) A consideration of this evidence does not lead the Court to believe that a reasonable jury could infer that Defendants acted with an intent to defraud or acted with severe recklessness in making statements concerning employment practices.

Moreover, Plaintiffs' own evidence demonstrates how Food Lion's policies were designed to prevent labor violations such as working off the clock. For example, although Plaintiffs have offered evidence of incident reports that show that Defendants were aware of instances of off the clock violations, in all but a few of these reports, the evidence also shows that Food Lion took some form of corrective or disciplinary action pursuant to Food Lion policy. (See Pls.' Exs. 26, 27, 29, 45, 47, 49, 60.) Similarly, although Plaintiffs have offered a memo from Tom Smith that demonstrates that he was also aware of off the clock problems, Tom Smith's memo to Jerry Helms, Senior Vice president and Chief Operating Officer of the company, solicits Helms' opinion as to the Audit Department's suggestions as to "what can be done to cut down on the amount of cheating done on Effective Scheduling." (Pls.' Ex. 11.) Finally, although Plaintiffs have offered evidence of employee statements such as "[w]orking 'off the clock' is a way of life at Food Lion," "Food Lion knows that people work off the clock," and "its impossible to get the job done if you don't [work off the clock]," (Pls.' Exs. 12-14), the Court notes that ill of these comments were solicited by Food Lion in its employee opinion surveys as a means of monitoring the effectiveness of its employment practices. As a result, the Court finds that, even when considering the Simonsen Letter, the evidence before this Court is not consistent with an intent to defraud the market. The Court finds that the evidence before this Court fails to support an inference that Defendants knowingly omitted material information about employees working off the clock from their Annual and Quarterly Reports, in bad faith, with an intent to defraud the market, or with severe recklessness. The Court therefore finds that Defendants are entitled to summary judgment based on the absence of

evidence of scienter as to the issue of omissions by Defendants as to the effect of the Effective Scheduling System on employees working off the clock.

b. Scienter With Respect To Poor Sanitation

The Court has previously determined that Plaintiffs' evidence fails to demonstrate that Food Lion had a widespread sanitation problem as a result of its Effective Scheduling System. Rather, the Court has found that the evidence simply shows isolated instances of workplace errors. The Court also has determined that this evidence of isolated instances of workplace errors is not material as a matter of law. Defendants argue that even if these isolated instances of misconduct are material, which they deny, Plaintiffs still have not presented any evidence that creates a genuine issue of material fact that Defendants, with scienter, omitted information about isolated instances of workplace misconduct. In support of this argument, Defendants have offered affidavits of thirty-seven managers, vice presidents, and other executives which all confirm that statements made in Defendants' Annual and Quarterly Reports about conditions throughout Food Lion stores were made in good faith and that no one had seen anything like the conditions depicted on PTL. Defs.' Exs. in Support of Food Lion's Mot. for Summ. J.)

Plaintiffs contend that the Simonsen Letter and Dr. Gilbreath's expert report, which the Court has discussed earlier, creates a genuine issue of material fact concerning whether Defendants acted with scienter when they omitted to disclose what they allegedly knew about the alleged sanitation problems throughout Food Lion stores. However,

the Court does not agree that this evidence demonstrates that Defendants acted with scienter by not disclosing what they knew about the isolated instances of sanitation problems in a few of Food Lion stores. First, with respect to the Simonsen Letter and the issue of scienter, the Court finds that the Simonsen Letter makes no mention of any sanitation problems nor draws any connection between Effective Scheduling and sanitation. Second, although Dr. Gilbreath gives his opinion that because store managers were evaluated based on their ability to effectively implement the Effective Scheduling System, this had the potential to cause the extensive and widespread practice by Food Lion managers, inter alia, to minimize time spent on certain fixed tasks, the Court finds that Dr. Gilbreath's opinion is not any evidence of an intent to defraud by Defendants. As a result, the Court finds that neither the Simonsen Letter nor the Gilbreath report are sufficient evidence from which a reasonable jury could infer that Defendants omitted information about any sanitation problems with the intent to deceive the market or with severe recklessness. Thus, the Court will grant Defendants summary judgment motions on the basis of lack of scienter with respect to Defendants' failure to disclose what Food Lion knew about any alleged sanitation problems in Food Lion stores.

4. Summary of the Court's Findings

Based on the above discussion, the Court finds that Plaintiffs are unable to demonstrate that any alleged omission concerning isolated instances of workplace errors is actionable as a matter of law because there is not a substantial likelihood that a reasonable investor would consider these isolated instances of workplace errors important in deciding whether to purchase Food Lion securities. Therefore, the

Court finds that Plaintiffs are unable to establish materiality as to any alleged omissions concerning isolated instances of workplace errors in sanitation in Food Lion stores.

The Court further finds that any alleged omission concerning the allegations of employees working off the clock, and the alleged effects of off the clock on Food Lion profits, was fully disclosed in the previously mentioned press releases and Food Lion's Annual and Quarterly Reports as of September 11, 1991. Therefore, as to those Plaintiffs who purchased Food Lion stock as of September 11, 1991, the Court finds that those Plaintiffs are unable to prove justifiable reliance on an alleged artificial stock price set by the market as a result of any optimistic statements about Food Lion's higher than industry profit margins.

To the extent that September 11, 1991 has been accepted by the Court as the date of disclosure, the Court further finds that as to those Plaintiffs who purchased Food Lion stock prior to September 11, 1991, the market was on notice at that time, or should have discovered, the risks associated with the allegations that Food Lion had engaged in labor violations. Because these Plaintiffs failed to bring an action within one year from the date of disclosure, the Court finds that those Plaintiffs who purchased Food Lion stock prior to September 11, 1991 are time barred by the one-year statute of limitation.

Finally, based on the Court's prior discussion of scienter, the Court finds that Plaintiffs have failed to offer evidence that Defendants acted with scienter by failing to disclose the alleged omission concerning working off the clock or the alleged omission concerning poor sanitation in Food Lion stores. As a result, the Court finds that as a matter

of law, based on the elements as set forth in Cooke, Plaintiffs have failed to demonstrate a securities fraud claim pursuant to § 10(b) and Rule 10b-5. fn25 Therefore, the Court will grant Defendant Food Lion and Defendant Tom Smith's motions for summary judgment as to Plaintiffs' securities fraud claim.

### B. PLAINTIFFS' SECURITIES FRAUD CLAIM UNDER SECTION 20(a)

It is well settled that where the primary liability § 10(b) claim fails, there can be no secondary controlling person liability under § 20(a). In re Cryomedical Sciences, 884 F. Supp. at 1011; 15 U.S.C. § 78t(a) (stating that a controlling person shall be liable to the same extent as such controlled person). Thus, because the Court has found that Plaintiffs have failed to demonstrate primary liability under § 10(b) of the Securities Exchange Act, the Court finds that Plaintiffs also cannot maintain a claim under § 20(a) against Defendant Tom Smith as a controlling person. The Court will grant Defendant Tom Smith's Motion for Summary Judgment as to this claim.

### C. STATE LAW CLAIMS

Finally, by granting Defendants' motions for summary judgment as to Plaintiffs' federal claims under §§ 10(b) and 20(a) of the Securities Exchange Act, the Court finds that there is no basis for exercising jurisdiction over Plaintiffs' state law claims for fraud, deceit, and negligent misrepresentation. See 28 U.S.C. § 1367(c). As a result, the Court will dismiss this action in its entirety.

## V. PLAINTIFFS' MOTION FOR PARTIAL SUMMARY JUDGMENT

Having granted Defendant Food Lion's Motion for Summary Judgment and Defendant Tom Smith's Motion for Summary Judgment, and having dismissed this action, the Court finds that Plaintiffs' Motion for Partial Summary Judgment is hereby rendered moot.

## VI. CONCLUSION

Motion to Respond [For the above stated reasons, Plaintiffs' Motion to Strike, or in the alternative, Document # 223] is denied. Defendant Food Lion's Motion for Summary Judgment [Document # 190] and Defendant Tom Smith's Motion for Summary Judgment [Document # 188] are granted and this action is dismissed. Plaintiffs' Motion for Partial Summary Judgment [Document # 192] is hereby rendered moot. An Order and Judgment consistent with this Memorandum Opinion will be filed contemporaneously herewith.

This, the ____ day of 1998.

United States District Judge

Footnotes

fn1Two separate, but substantially identical, complaints initially were filed by the present group of Plaintiffs. The Longman Complaint was filed on November 12, 1992, and the Feinman Complaint was filed on November 13, 1992. The Longman Complaint was amended on January 20, 1993. Finding that the Longman and Feinman cases are identical for all practical purposes, Judge Erwin consolidated these cases in an Order filed with this Court on March 16, 1994. For purposes of the discussion in this Memorandum Opinion, both the Longman Amended Complaint and the Feinman Complaint raise the same issues before this Court and will jointly be referred to as "the Complaint."

fn2 October 17, 1994 Order [Document # 53] granting Plaintiffs' Motion to Certify Class.

fn3 Section 10(b) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means.
>
> > (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U S.C. § 78j(b).

fn4 Section 20(a) provides:

> (a) Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

15 U.S.C. § 78t(a).

fn5 15 U.S.C. §§ 78a et seq.

fn6 Rule 10b-5 provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5.

fn7 Defense Thirteen alleges that the United Food and Commercial Worker's Union ("UFCW") and others acting in concert with it had been engaging in a "corporate campaign" to attack and cause injury to the business and property of Food Lion with the intention of eliminating and reducing competition from Food Lion in markets where the UFCW represented employees of competing retail stores. Defense Fourteen claims that ABC did not accurately broadcast the facts concerning Food Lion and that the UFCW and ABC acted to reinforce the negative impact of the PTL story. Defenses Fifteen and Sixteen assert equitable estoppel defenses. Defense Seventeen asserts an in pari delicto defense. Defense Eighteen asserts an unclean hands defense.

fn8 Plaintiffs' and Defendants' briefs also discuss statements made by Senator Tom Lantos at a congressional hearing before the Employment and Housing Subcommittee. Plaintiffs offer Senator Lantos' statements to counter Defendants' argument that some Food Lion employees voluntarily worked off the clock. (See Pls.' Mem. of Law in Opp'n to Food Lion's Mot. for Summ. J. at 9-10.) However, because Senator Lantos' statements are not relevant to the issues discussed in this Memorandum Opinion, the Court declines to address the admissibility of these statements.

fn9After a review of all of the statements, particularly those emphasized by Plaintiffs, the Court notes that many of these statements are not actionable because they are forward looking statements about Food Lion's prospects in the future. See Raab v. General Physics Corp., 4 F.3d 286, 289 (4th Cir. 1993) (stating that predictions about future growth are not material). If this was the basis of Plaintiffs' claim, then there would be no securities fraud claim as to those statements because soft, puffing statements are generally not material as

a matter of law. See Recognizing this, Plaintiffs argued at the February 18, 1998 hearing that this is not a case about projections. Rather, as Plaintiffs argued, this is a case about what Defendants omitted to say in their Annual and Quarterly Reports about current facts concerning Food Lion. Therefore, the Court will not discuss this case in the context of a projections case to determine whether the statements made in the Annual and Quarterly Reports are actionable or are merely soft statements generally not actionable as a matter of law. Rather, the Court will address Plaintiffs' arguments that Defendants engaged in securities fraud because Defendants omitted material information from Food Lion's Annual and Quarterly Reports.

fn10 In addition to the PTL broadcast, Plaintiffs have also submitted forty hours of undercover footage as an exhibit in response to Defendants' motions for summary judgment.
(See Pls.' Ex. 66.) However, Plaintiffs state that "[for the purposes of ruling on this [summary judgment] motion, Plaintiffs believe that it is sufficient for the Court to consider only the PTL Video and other materials submitted by Plaintiffs, without need to resort to the undercover footage." (Pls. Resp. to Defs.' Supp. Mem. on the Admiss. of PrimeTime Live Broadcast at 1 n.1.) Therefore, because Plaintiffs state that the forty hours of unedited footage supports and confirms the accuracy of the edited PTL broadcast (see Pis.' Mem. of Law in Opp'n to Food Lion's Mot. for Summ. J. at 3 and because Plaintiffs believe that the PTL broadcast is sufficient for purposes of the summary judgment motions before this Court, the Court will not consider the content of this unedited footage and will consider only the PTL broadcast as made available to this Court through a transcript of the broadcast. See Pls.' Ex. A,

attached to Pls.' Resp. to defs.' Supp. Mem. on Admiss. of PTL.)

fn11 Hearsay is defined as "a statement, other than one made by the declarant while
testifying at the trial . . . offered . . . to prove the truth of the matter asserted." Fed. R. Evid. 80 1(c).

fn12 Although the PTL broadcast also contains statements by two "experts in the field of food handling and safety," Plaintiffs make no arguments concerning whether these statements are admissible. Therefore, the Court declines to address the admissibility of these statements.

fn13 Rule 803(1) provides that "[a] statement describing or explaining an event or condition made while the declarant was perceiving the event or condition, or immediately thereafter," is not excluded by the hearsay rule. Fed. R. Evid. 803(1).

fn14 Rule 803(2) provides that "[a] statement relating to a startling event or condition made while the declarant was under the stress of excitement caused by the event or condition" is not excluded by the hearsay rule. Fed. R. Evid. 803(2).

fn15 Rule 803(3) provides that "[a] statement of the declarant's then existing state of mind, emotion, sensation, or physical condition (such as intent, plan, motive, design, mental feeling, pain, and bodily health), but not including a statement of memory or belief to prove the fact remembered or believed unless it relates to the execution, revocation, identification, or terms of declarant's will" is not excluded from the hearsay rule. Fed. R. Evid. 803(3).

fn16 Rule 804 provides in pertinent part:

> (a)Definition of unavailability. "Unavailability as a witness" includes situations in
> which :the declarant-
>
> (1)is exempted by ruling of the court on the ground of privilege from testifying concerning the subject matter of the declarant's statement; or
>
> (2)persists in refusing to testify concerning the subject matter of the declarant's statement despite an order of the court to do so; or
>
> (3)testifies to lack of memory of the subject matter of the declarant's statement; or
>
> (4)is unable to be present or to testify at the hearing because of death or then existing physical or mental illness or infirmity; or
>
> (5)is absent from the hearing and the proponent of a statement has been unable to procure the declarant's attendance or testimony. . . by process or other reasonable means. .
>
> (b)Hearsay exceptions. The following are not excluded by the hearsay rule if the declarant is unavailable as a witness:
>
> (3)Statement against interest. A statement which was at the time of its making so far contrary to the declarant's pecuniary or proprietary interest, or so far tended to subject

> the declarant to civil or criminal liability, . . . that a reasonable person in the declarant's position would not have made the statement unless believing it to be true.

fn17 The Court is also not persuaded by Plaintiffs' argument that the Court should consider the statements made by the former employees regardless of any exception to the hearsay rule.(See Pls.' Resp. to Defs.' Supp. Mem. on the Admiss. of PTL at 10-12.)

fn18 Rule 1006 provides, in pertinent part, that "[t]he contents of voluminous writings, records, or photographs which cannot conveniently be examined in court may be presented in the form of a.. summary." Fed. R. Evid. 1006.

fn19Although Plaintiffs have offered an affidavit of Jean Bull, who is a former employee of Food Lion, (see Pls.' Ex. C, attached to Pls.' Resp. to Defs.' Supp. Mem. on the Admiss. of PTL), the Court notes that Jean Bull is also one of the former employees interviewed on the PTL broadcast and that her affidavit merely contains the same allegations that she makes on the PTL broadcast. As a result, Jean Bult s affidavit does not present any additional evidence to what has already been disclosed in the PTL broadcast.

fn20 Plaintiffs' argue that this Court should accept as true what is disclosed in the PTL broadcast because, as Plaintiffs contend, in Food Lion, Inc. v. Capital Cities/ABC. Inc., 964 F.Supp 956 (M.D.N.C. 1997), Judge Tilley found the PTL broadcast to be reliable evidence of what it showed. (See Pls.' Resp. to Defs.' Supp. Mem. on Admiss of PTL at 19.) However, this Court notes that Judge Tilley, in fact, stated that "[for the purposes of this opinion and this case, it

is assumed that the content of the PrimeTime Live broadcast about Food Lion was true." Capital Cities, 964 F. Supp. at 959 (emphasis added). Therefore, the Court is not persuaded by Plaintiffs' argument.

fn21 Rule 803(8) provides:

> Records, reports, statements, or data compilations, in any form, of public offices or agencies, setting forth, . . . (C) in civil actions and proceedings . . . factual findings resulting from an investigation made pursuant to authority granted by law, unless the source of information or other circumstances indicate a lack of trustworthiness. Fed. R. Evid. 803(8)(C).

fn22 Rule 801(d)(2)(C) provides:

> A statement is not hearsay if--.. . (2) Admission by party-opponent. The statement is offered against a party and is . . . (C) a statement by a person authorized by the party to make a statement concerning the subject. Fed. R. Evid.80 1(d)(2)(C).

fn23 In order to explain Food Lion's prior policy towards selling prepackaged meats after the manufacturers sell-by date, Defendants have offered an affidavit of Wayne Jones, who was the Regional Market and Deli Supervisor during the Class Period. Jones notes that although prepackaged meats had a manufacturer's expiration date, these meats also said that the product was fresh up to seven days after the expiration date. Therefore, Food Lion's policy before PTL was to reduce these meats during this seven day period and sell them in a special "reduced" basket in the store. (Jones Aff. ¶ 7.) After the PTL broadcast, Food Lion no

longer offered prepackaged meats after the manufacturer's sell-by date at a reduced rate in order to avoid any misunderstanding by the public as to Food Lion's policy. (Id.)

fn24 Although in Cooke, 998 F.2d at 1261, the second prong of a securities fraud prima facie case is scienter, prior to discussing scienter, the Court elects to discuss the third prong of justifiable reliance as it relates to the alleged omission that Food Lion's higher than average profit margins were attributable to employees working off the clock.

fn25 Based on the Court's finding that Plaintiffs failed to establish at least two elements for either of the alleged omissions, the Court does not find it necessary to discuss the remaining causation and damages elements as set forth in Cooke, 998 F.2d at 1261.

Filed 11/5/99

No. 98-2116

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

DAVID I. LONGMAN; JEFFREY FEINMAN; PAUL M. GARDNER, Defined Plan Trust; EDWARD HANKIN; LINDA HANKIN,
Plaintiffs-Appellants,

v.

FOOD LION, INCORPORATED; TOM E. SMITH,
Defendants-Appellees,

and

LYNNE NEUFER-DALE,
Respondent,

ROBERT HARBRANT; JEFFREY FIEDLER; KEITH MESTRICH; SEAN CUNNIFF; FOOD AND ALLIED SERVICE TRADES DEPARTMENT, AFL-CIO; RESEARCH ASSOCIATES OF AMERICA; NEEL LATTIMORE; NICHOLAS W. CLARK; MAUREEN DWYER; ALLEN Y. ZACK; CHARLES L. ULSCH; SUSAN BARNETT; COOPERS & LYBRAND, LLP, Movants.

Appellants have filed a petition for rehearing and rehearing en banc and a motion to seal petition.

The appellants' petition for rehearing and rehearing en banc was submitted to this Court. As no member of this

Court or the panel requested a poll on the petition for rehearing en banc, and As the panel considered the petition for rehearing and motion to seal and is of the opinion that it should be denied,

IT IS ORDERED that the petition for rehearing and rehearing en banc and the motion to seal is denied.

For the Court,

/s/ Patricia S. Connor

CLERK

Supreme Court, U.S.
FILED
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No. 99-1313

# In the Supreme Court of the United States

DAVID I. LONGMAN; JEFFREY FEINMAN; PAUL M. GARDNER, Defined Plan Trust; EDWARD HANKIN and LINDA HANKIN,

*Petitioners,*

v.

FOOD LION, INCORPORATED; TOM E. SMITH,

*Respondents.*

**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit**

## Respondents' Brief in Opposition

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March 6, 2000

2748

## QUESTION PRESENTED

In a securities fraud action based upon a television program's allegations that a company engaged in widespread labor law violations, where it is undisputed that those same allegations had been made over a year earlier by another source, were fully disclosed to the market, and were settled for an immaterial amount, does a question regarding the credibility of the original source of the allegations raise a triable issue of fact that precludes summary judgment?

## CORORATE DISCLOSURE STATEMENT

Pursuant to this Court's Rule 29.6, the only parent corporation or publicly held company that owns 10% or more of Food Lion, Inc.'s stock is Etablissements Delhaize Freres et Cie "Le Lion" S.A., which holds Food Lion, Inc. stock directly as well as indirectly through its wholly-owned subsidiary, Delhaize The Lion America, Inc.

## TABLE OF CONTENTS

Page

QUESTION PRESENTED ..... i
CORPORATE DISCLOSURE STATEMENT ..... ii
TABLE OF CONTENTS ..... iii
TABLE OF AUTHORITIES ..... iv
STATEMENT OF THE CASE ..... 1
A. Background ..... 2
B. The *Carpenter* Complaint ..... 3
C. The *PrimeTime Live* Broadcast ..... 7
D. The Securities Fraud Allegations ..... 8
E. The Decisions of the Courts Below ..... 9
REASONS TO DENY THE WRIT ..... 12
I. THE DECISION BELOW DOES NOT RAISE THE ISSUE PRESENTED IN THE PETITION ..... 12
II. THE COURT WOULD NOT REACH THE ISSUE PRESENTED IF THE WRIT WERE GRANTED ..... 18
III. THE UNDISPUTED EVIDENCE THAT THE CLAIMS OF WIDESPREAD LABOR LAW VIOLATIONS WERE SETTLED FOR AN AMOUNT CONCEDED TO BE IMMATERIAL, AND THE DISTRICT COURT'S RULING THAT PETITIONERS DID NOT ESTABLISH SCIENTER, DISPEL ANY REASON FOR REVIEW ..... 19
CONCLUSION ..... 21

## TABLE OF AUTHORITIES

Page

**Cases:**

*Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242 (1986) ..... 20
*Basic Inc. v. Levinson*, 485 U.S. 224 (1988) ..... 15, 16, 18
*Berry v. Valence Tech., Inc.*, 175 F.3d 699 (9th Cir.), *cert. denied*, 120 S. Ct. 528 (1999) ..... 15
*Cooke v. Manufactured Homes, Inc.*, 998 F.2d 1256 (4th Cir. 1993) ..... 15
*Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) ..... 17, 20
*Hillson Partners Ltd. Partnership v. Adage, Inc.*, 42 F.3d 204 (4th Cir. 1994) ..... 15, 18
*Hormel v. Helvering*, 312 U.S. 552 (1941) ..... 19
*In re Apple Securities Litigation*, 886 F.2d 1109 (9th Cir. 1989) ..... 15
*In re Sofamor Danek Group, Inc.*, 123 F.3d 394 (6th Cir. 1997), *cert. denied*, 523 U.S. 1106 (1998) .... 16, 17
*Malone v. Microdyne Corp.*, 26 F.3d 471 (4th Cir. 1994) ..... 15
*Moody v. Empire Life Ins. Co.*, 849 F.2d 902 (5th Cir. 1988) ..... 18
*Muth v. United States*, 1 F.3d 246 (4th Cir. 1993) ..... 19
*Provenz v. Miller*, 102 F.3d 1478 (9th Cir. 1996), *cert. denied*, 522 U.S. 808 (1997) ..... 15
*Raab v. General Physics Corp.*, 4 F.3d 286 (4th Cir. 1993) ..... 15
*Sailor v. Northern States Power Co.*, 4 F.3d 610 (8th Cir. 1993) ..... 15
*Shaw v. Digital Equip. Corp.*, 82 F.3d 1194 (1st Cir. 1996) ..... 15

*Skipper v. French*, 130 F.3d 603 (4th Cir. 1997) ..... 19
*Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509 (7th Cir. 1989) ..... 16

**Statutes:**

Fair Labor Standards Act, 29 U.S.C. § 201 *et seq.* ..... 4
Fed. R. Civ. P. 9(b) ..... 18
Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) ..... 8
Securities Exchange Act of 1934, 15 U.S.C. § 78t(a) ..... 8

**Regulation:**

17 C.F.R. § 240.10b-5 ..... 8

## STATEMENT OF THE CASE

In its decision in this case, the United States Court of Appeals for the Fourth Circuit rejected petitioners' attempt to premise a securities law violation on a television broadcast's unproven allegations of widespread off-the-clock work by Food Lion employees. Although Food Lion had repeatedly and publicly disclosed the existence of similar claims for over a year prior to the broadcast, petitioners nevertheless contended that the broadcast marked the first time that the public was credibly informed of the existence of the alleged violations and of the purported dependence of Food Lion's profits on those violations. Recognizing that the broadcast merely repeated claims that had long since been disclosed, the court held that the broadcast added nothing to the information already available to the marketplace, and thus that petitioners had failed to show that Food Lion had improperly withheld any material information.

Contrary to petitioners' contentions, the Fourth Circuit's ruling did not eliminate the presumption of reliance created by the "fraud on the market" theory by permitting public statements to establish market knowledge without regard to the credibility of the statements' source. The "credibility" of the prior *allegations* was not an issue, because the *allegations* of the broadcast, even if viewed as more credible than the earlier claims, did not establish the existence of a "fact" that rendered prior statements by Food Lion misleading. The existence of anything other than isolated, sporadic instances of off-the-clock work typical for a company of Food Lion's size has never been established. No decision of this or any other court required Food Lion to disclose the existence of a "fact" that it did not know to be true. At most, all that Food Lion was required to disclose was the existence of the allegations, which it unquestionably did. The court of appeals

had no occasion to consider whether the "truth on the market" defense to a securities fraud claim can be established without regard to the credibility of the source of the information.

**A. Background**

Food Lion, a publicly traded retail grocery company, was the fastest growing grocery store chain in the country in the late 1980's and early 1990's. By 1992, Food Lion operated approximately 1,000 stores, primarily in the southeastern part of the United States, had approximately 60,000 active employees, and had earnings exceeding $200 million per year.

Petitioners' assertion that Food Lion's management was aware of widespread labor law violations during this time period, Pet. at 7, was squarely rejected by the district court. Undisputed evidence showed that Food Lion had a strict corporate policy against off-the-clock work by its employees, and regularly audited its stores for compliance with this policy. Nevertheless, like any company of its size, Food Lion occasionally received reports that an employee had worked off the clock. Such reports were investigated and any violations were corrected. The information collected through Food Lion's internal controls and audits showed that off-the-clock work occurred relatively infrequently and any infractions were dealt with appropriately and effectively.

Petitioners' attempt to characterize the product of Food Lion's oversight efforts as "extensive" evidence of "widespread illegal labor practices," Pet. at 7, is refuted by an examination of the documents themselves, as the district court held. App. 101a-105a. For example, the "report . . . prepared by a Food Lion lawyer," which petitioners characterize as concluding that off-the-clock work was "unavoidable" under Food Lion's scheduling system, Pet. at 7, in fact only

speculated that Food Lion's scheduling system might result in future off-the-clock violations, and documented no current violation. The "internal survey responses . . . from employees of more than 30 Food Lion stores," *id.*, reflected complaints from a very small fraction of the approximately 60,000 employees who worked for Food Lion at the time. The "internal investigative reports" and "internal memoranda" on which petitioners relied, far from documenting "rampant" or "widespread" violations, Pet. at 7-8, again reflected the experiences of only a small portion of Food Lion's total workforce. Indeed, as the district court noted, rather than establishing widespread violations of Food Lion's policy against off-the-clock work, the evidence adduced by petitioners showed that Food Lion actively and diligently enforced that policy.[1] App. 103a-105a.

**B. The *Carpenter* Complaint**

Food Lion first became aware of allegations of widespread violations on September 11, 1991, when it received a copy of a complaint filed by the United Food and Commercial Workers International Union ("UFCW") with the U.S. Department of Labor ("DOL") (the "*Carpenter* complaint"). The complaint, which was purportedly filed on behalf of 183 current and former Food Lion employees and listed 223 additional employees alleged to have similar claims, asserted that Food Lion was liable for up to $338 million for

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[1] To support their claim of unlawful labor practices, petitioners also point to two settlement agreements between Food Lion and the U.S. Department of Labor in 1989 and 1990 in which Food Lion agreed to pay $300,000 in back pay related to off-the-clock work and to monitor and enforce its compliance with the FLSA. Pet. at 10 n.1. However, as the amount of the settlement suggests, these settlements involved only a small number of claims, were not indicative of widespread problems, and did not result in material liability.

permitting employees to work "off the clock" without pay in violation of the Fair Labor Standards Act ("FLSA"), 29 U.S.C. § 201 *et seq.* The complaint also alleged that $64 million of Food Lion's annual profit margins was attributable to such off-the-clock work. In a press release issued the same day as the complaint, the UFCW claimed that the allegations were based on an investigation that "uncovered violations in 141 stores in 88 cities in seven states." The names of the employees alleged to have worked off the clock were redacted from the copy of the complaint provided to Food Lion, which made it impossible for Food Lion to evaluate the claims.[2]

The UFCW's allegations were widely disseminated and publicized, were known to professional analysts in the securities industry, and resulted in a drop in the price of Food Lion's stock the day after the announcement. Food Lion also disclosed the filing of the *Carpenter* complaint in filings with the Securities and Exchange Commission ("SEC").[3] The

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[2] By the time the *Carpenter* complaint was resolved in 1993, Food Lion had learned the names of only 22 of the claimants.

[3] For example, in its Form 10Q, filed with the SEC on October 22, 1991, Food Lion made the following disclosure:

> On September 11, 1991, a Complaint was filed with the United States Department of Labor, Wage and Hours Division by the United Food and Commercial Workers International Union on behalf of a number of present and former employees of the Company, alleging that the Company is engaged in violations of the Fair Labor Standards Act . . . . In the Complaint, it is alleged that, among other things, the Company engaged in (a) repeated and willful failure to pay hourly employees overtime compensation in violation of the FLSA, (b) willful discrimination and retaliation against employees who attempted to exercise their rights under the FLSA, and (c) willful falsification and alteration of employees' time records, and failure to keep proper and required time records, in violation of

allegations were further publicized in March and September 1992, when a committee of the United States House of Representatives convened hearings to review the DOL's response to the *Carpenter* complaint.

In the months that followed the filing of the *Carpenter* complaint, former employees filed eleven lawsuits against Food Lion alleging, among other things, that they had been required to work off the clock in violation of the FLSA. Although most of these lawsuits were filed as "collective" actions, Food Lion could do little to investigate the allegations beyond looking into the particular circumstances of the individuals who were named in the complaints. Food Lion publicly disclosed the existence of the litigation and the nature of the allegations in filings with the SEC.[4] As with the

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> the FLSA. The complainants request that the Department of Labor conduct an immediate investigation into the alleged violations and bring suit on behalf of the affected class of present and former employees of the Company to obtain damages and civil monetary penalty for past violations and injunctive relief against future violations.
>
> Management and legal counsel for the Company are currently investigating and evaluating the allegations contained in the Complaint. The Company has not been notified whether the Department of Labor will conduct an investigation into the allegations.
>
> The ultimate liability, if any, which may result is not presently determinable; however, in the opinion of management, any liability will not have a material adverse affect on the financial condition of the Company. Management believes that the Company has meritorious defenses to the allegations and the Company intends to defend the allegations vigorously.

[4] For example, Food Lion's Form 10Q filed March 27, 1992, provided the following description of one such lawsuit:

> On October 16, 1991, Donald T. Ledford and Michael J. Oakes, former employees of the Company, filed a Complaint with the

*Carpenter* complaint itself, however, Food Lion's management had considerable doubts about the validity of the allegations of widespread wage and hour violations alleged in the lawsuits, since those allegations were contradicted by Food Lion's internal reports and audits, and investigation of the relative handful of individuals identified in the various complaints provided no basis for believing that any violations were other than sporadic.

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United States District Court for the Western District of North Carolina under the FLSA . . . . Plaintiffs purported to bring the action "on behalf of persons who are 'employees' within the meaning of FLSA, all of whom have been damaged by the acts and practices complained of herein." The Complaint alleged that the named Plaintiffs routinely worked hours in excess of 40 per week but were not compensated for the overtime as required under the FLSA. The Complaint further alleged that the Company had actual or constructive knowledge of the overtime work and "suffered, permitted and/or required that hours in excess of 40 hours per week be worked." Plaintiffs seek compensatory and liquidated damages "in an amount in excess of $10,000" under the FLSA, together with attorneys' fees, other litigation and court costs, and an injunction prohibiting further violations of the FLSA. Plaintiffs also assert in the alternative a pendant state law claim for compensation for unpaid hours worked under the doctrine of unjust enrichment and *quantum meruit*. On October 23, 1991, Plaintiff submitted an Amended Complaint which added the names of Michael Cardoza, R. Chuck Villarreal, Jr., Roy Sarter, and Larry Worley as named plaintiffs. The Amended Complaint adds an allegation that the Company's policies, including "effective scheduling," cause or result in "off-the-clock" work. The requested relief remains the same under the Amended Complaint. Since the filing of the Complaint and Amended Complaint, an additional 25 former Food Lion employees have filed notices with the Court seeking to be parties to this proceeding.

In the summer of 1993, despite the DOL's continued refusal to provide Food Lion with sufficient information to permit an investigation of the *Carpenter* complaint and the absence of any evidence from its internal audits and surveys of any widespread problem, Food Lion decided to settle the *Carpenter* complaint in order to avoid the economic and reputational injuries that would have accompanied the threatened DOL action regardless of its ultimate outcome. The settlement agreement required Food Lion to pay $16.2 million, including $13.2 million in back wages for current and former employees. Under the terms of the settlement, payments were to be made to employees whether or not they claimed to have worked off the clock. The summary judgment record before the district court below included testimony from expert witnesses for both petitioners and Food Lion agreeing that the amount of the *Carpenter* settlement was immaterial relative to Food Lion's earnings.

### C. The *PrimeTime Live* Broadcast

On November 5, 1992, the ABC television program *PrimeTime Live* ("*PTL*") devoted approximately twenty-three minutes of an hour long broadcast to a segment purporting to disclose widespread sanitation problems and labor law violations at grocery stores owned by Food Lion. Although the undercover videotape that gave the show the appearance of authenticity had been filmed at only three out of approximately 1,000 Food Lion stores, the program created the impression that the conditions described in the broadcast could be found throughout the chain. The program suggested that the alleged sanitation problems and labor law violations were attributable to Food Lion's scheduling system, which ABC characterized as providing too little time for employees to complete assigned tasks. Most of the program focused on the alleged sanitation problems; although ABC repeated the

UFCW's allegations and presented seven individuals who claimed to have worked off the clock, the program did not document a single incident of off-the-clock work.

Food Lion denied the *PTL* allegations, and denies them to this day. Nevertheless, the day after the show aired, the price of Food Lion stock fell just over ten percent. Food Lion presented uncontroverted evidence that the reason for the change was not that investors believed the allegations, but that they were concerned that the program's sensationalized allegations of unhealthy food handling practices would cause shoppers to take their business elsewhere.

**D. The Securities Fraud Allegations**

One week after the *PTL* broadcast, petitioners filed the two lawsuits that were subsequently consolidated into this action. Both complaints alleged violations of § 10(b) and § 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) and 78t(a) and Rule 10b-5, 17 C.F.R. § 240.10b-5, as well as fraud, deceit, and negligent misrepresentation under North Carolina law. Treating the allegations of the broadcast as if they were established fact, petitioners claimed that Food Lion had violated the securities laws by failing to disclose[5] in

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[5] In characterizing the "gravamen" of their complaints as being that Food Lion and Tom Smith "failed to disclose, *and expressly denied*, widespread illegal labor practices that artificially inflated its stock earnings and margins and, in turn, the value of its stock," Pet. at 4 (emphasis added), petitioners materially misstate the position they took below. As the district court expressly noted in its opinion, at the hearing on Food Lion's motion for summary judgment petitioners argued that "this is a case about what Defendants *omitted to say* in their Annual and Quarterly Reports about current facts concerning Food Lion. . . . [T]he Court will address Plaintiffs' arguments that Defendants engaged in securities fraud because Defendants *omitted material information* from Food Lion's Annual and Quarterly Reports." App. 112a n.9 (emphasis added)]. The only

filings with the SEC that its growth in size and profitability was attributable to a policy that caused employees to neglect sanitation practices and perform large portions of their work "off-the-clock." Petitioners identified fourteen specific statements in annual and quarterly reports filed by Food Lion with the SEC that they claimed were misleading or failed to disclose material facts regarding the sanitary conditions in its stores and the dependence of its operating margins and profits on its allegedly unlawful policies.[6] Significantly, *none* of the statements relied on by petitioners in their petition for certiorari (Pet. at 8-14) was included in the list of statements alleged in their complaints to be false or misleading.

**E. The Decisions of the Courts Below**

After extensive discovery, Food Lion and Tom Smith moved for summary judgment. In a lengthy (55-page) decision, the district court granted their motion. With respect to petitioners' sanitation claims, the court found that petitioners' evidence established only isolated instances of workplace errors that a reasonable investor would not find material as a matter of law. With respect to petitioners' claims of widespread labor law violations, the court found that the press releases issued after the filing of the *Carpenter* complaint and Food Lion's quarterly and annual filings with the SEC fully disclosed the existence of the allegations and the alleged effects of off-the-clock work on Food Lion's

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"denials" that petitioners point to are statements that they did not challenge as fraudulent in the district court. Petitioners' characterization attempts to shift their theory of the case from the omissions case that they argued in the district court to the misleading statement case that they believe they need to obtain review here.

[6] A complete list of the statements that petitioners challenged in their complaints is listed in the district court's opinion. App. 60a-65a.

profits, and therefore that petitioners could not prove justifiable reliance on an artificially inflated stock price. The court also held with respect to both claims that petitioners had failed to offer evidence that Food Lion or Tom Smith acted with scienter in failing to disclose problems with poor sanitation or labor law violations in Food Lion stores. Because petitioners failed to establish liability under Section 10(b), the court also dismissed their claim against Tom Smith under Section 20(a). Significantly, *none* of the statements relied on by petitioners in their petition for certiorari was challenged as false or misleading in their opposition to Food Lion's motion or was addressed by the district court in ruling on that motion.

The Fourth Circuit affirmed.[7] With respect to the claims of widespread labor law violations, the court noted that the general statements that appeared in Food Lion's annual and quarterly reports constituted "immaterial puffery that is not actionable under the securities laws," had not been shown to be untrue, and did not bear on the claims of off-the-clock work in any event. App. 25a n.2. The court then turned to petitioners' contention that Food Lion's statements denying the allegations of widespread labor law violations in the *Carpenter* complaint were misleading.[8] The court concluded that the statements were not actionable because the risk to

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[7] With respect to the sanitation claims, the court agreed with the district court that petitioners' evidence showed, at most, only isolated instances of workplace errors, and that these isolated instances were not material to the price of Food Lion's stock. App. 23a. Petitioners do not challenge this portion of the court's ruling.

[8] The court of appeals did not address Food Lion's objection to the court's consideration of those statements on the grounds that they had been identified as actionable neither in petitioners' complaints nor in the summary judgment proceeding in the district court, presumably because the issue was mooted by its disposition of the issues it did address.

earnings that such claims presented had previously been disclosed to the market. "The market had a full opportunity to evaluate these claims and to reflect their risk in the market price for Food Lion stock. . . . The PrimeTime Live broadcast added nothing to inform the market further." App. 19a.

> Because the market was thus informed of the union's charges before PrimeTime Live aired, what Prime Time Live disclosed was not material. Indeed, even the much larger problem alleged more than a year earlier by the union was not material. Food Lion settled all of the claims made by the union with the Department of Labor for $16.2 million, $8.1 million payable in each of 1993 and 1994. During the same period, Food Lion's earnings exceeded $200 million per year. Experts on both sides agree that this settlement, reflecting a charge of less than two cents per share for each year, was not material to Food Lion's stock price. And consistent with this conclusion, Food Lion's share price did not drop following announcement of the Department of Labor settlement.

App. 20a.

## REASONS TO DENY THE WRIT

The Court should deny the Petition for three reasons. *First*, the issue framed by petitioners was not decided or addressed by the court below, and the position that petitioners ascribe to the court is not implicit in the court's decision. The court's analysis of the issues it did consider is fully consistent with the decisions of this Court and other courts of appeals. *Second*, this case would not present a good vehicle for addressing the issue presented in any event, because of the presence of collateral questions that would have to be decided before the issue could be considered. *Third*, the presence of alternative, unchallenged grounds for affirming the district court's decision will require that the decision be affirmed without regard to the resolution of the issue presented, rendering consideration of the issue an unwise investment of this Court's time.

### I. THE DECISION BELOW DOES NOT RAISE THE ISSUE PRESENTED IN THE PETITION

According to petitioners, the Fourth Circuit ruled that the fraud-on-the-market presumption of reliance may be rebutted by a public statement that provides accurate information to the market, without regard to the credibility of the public statement's source. Pet. at 3. Petitioners contend that review should be granted because the Fourth Circuit's analysis "promises to effectively eliminate the fraud on the market presumption in that jurisdiction." *Id.* The court of appeals made no such ruling, and its analysis presents no risk to the continued viability of the fraud-on-the-market presumption in the Fourth Circuit.

At the outset, it should be noted that petitioners have misstated the holdings of both the district court and the court of appeals. According to petitioners, the "district court ruled

that Food Lion's illegal labor practices were fully disclosed to the public on September 11, 1991—the date of an announcement by the [UFCW] that it had filed a complaint against Food Lion with the United States Department of Labor." Pet. at 4. Similarly, petitioners state that the "[t]he sole ground articulated by the court below for affirmance on the labor practices question was that the UFCW's September 11, 1991 press release fully disclosed to the market the existence of Food Lion's widespread illegal labor practices." Pet. at 17. Contrary to these characterizations, neither court based its ruling solely on the UFCW's press release. The district court explained as follows:

> [B]ased on the evidence before this Court, the Court finds that the numerous press releases *beginning September 11, 1991, as well as* Food Lion's disclosure of employee allegations of labor violations in the same Annual and Quarterly Reports which Plaintiffs contend omitted this same information, informed the market of the potential risks associated with the employee allegations of working off the clock in violation of the FLSA. The Court finds that *the market was repeatedly made aware* that Food Lion was facing numerous employee complaints of working off the clock as a result of the Effective Scheduling System and that thirty-seven percent of Food Lion's profits possibly were attributable to employees working off the clock. In the face of the substantial disclosure of the risks that Food Lion faced based upon the allegations of labor violations, the Court finds that any further disclosure about the specifics of Food Lion's questioned labor practices would not be material as a matter of law.

App. 94a (emphasis added); *see also id.* at 96a-97a. Similarly, the Fourth Circuit referred to the September 11

press release only as one of a number of ways the relevant information was disclosed to the market.

> Plaintiffs' securities fraud claim cannot succeed because, despite the fact that Food Lion denied the charges, the nature of the off-the-clock claims and the claims' risk to earnings were in fact well known to the market before the PrimeTime Live broadcast, and therefore Food Lion's omissions were not material. . . . *On September 11, 1991, for instance*, more than a year before the PrimeTime Live broadcast, the UFCW publicly announced that it had filed a complaint with the Department of Labor, asserting that 183 people had claimed to have illegally worked off the clock, that "[m]ore than 37 percent of the after tax profit" of Food Lion was attributable to off the clock work, and that "Food Lion could owe as much as $194 million in back wages."

App. 19a (emphasis added).

These excerpts make clear that the courts below did not base their decisions on a factual determination that the UFCW's September 11, 1991 press release was as credible a source as the November 5, 1992 *PTL* broadcast. Rather, the courts recognized that the broadcast, like the press release, merely informed the market of *allegations* of unproven violations, and that those *allegations* had already been fully disclosed on numerous occasions prior to the broadcast, including disclosures by Food Lion itself. In these circumstances, the relative credibility of the various sources of the allegations simply was not a factor in the courts' decisions.

The Fourth Circuit's analysis is in no way inconsistent with decisions of this Court and other courts of appeals. None of the cases cited by petitioners holds a company liable for failing to disclose as fact information that the company

does not know to be true. For example, in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), which endorsed the fraud-on-the-market theory, the defendant company publicly denied that it was engaged in merger negotiations when in fact it was engaged in such discussions; although the company disputed whether it was required to disclose the negotiations, there was no dispute that it knew of their existence at the time of its denials.[9] Similarly, in *In re Apple Securities Litigation*, 886 F.2d 1109 (9th Cir. 1989), the only statements that the court held to be actionable were made at a time when the company indisputably knew that its own internal tests showed the statements to be false. *Id.* at 1115.[10] In these circumstances,

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[9] The Fourth Circuit clearly did not understand its decision to conflict with *Basic*, which it relied on in its opinion (App. 24a-25a n.1) and had cited in previous decisions discussing the fraud-on-the-market theory. *See, e.g., Raab v. General Physics Corp.*, 4 F.3d 286, 289 (4th Cir. 1993); *Malone v. Microdyne Corp.*, 26 F.3d 471, 476 n.5 (4th Cir. 1994); *Cooke v. Manufactured Homes, Inc.*, 998 F.2d 1256, 1261 (4th Cir. 1993). *See generally Hillson Partners Ltd. Partnership v. Adage, Inc.*, 42 F.3d 204 (4th Cir. 1994) (summarizing cases).

[10] In *Provenz v. Miller*, 102 F.3d 1478 (9th Cir. 1996), *cert. denied*, 522 U.S. 808 (1997), which petitioners also cite, the plaintiffs' evidence was held sufficient to create a triable issue regarding falsity of the company's public statements, and the case was remand for further proceedings on that issue. None of the cases cited by petitioners provides any discussion bearing on the application of the truth-on-the-market defense in the context of unproven allegations, and nothing in any of the cases is remotely inconsistent with the Fourth Circuit's opinion. *See, e.g., Berry v. Valence Tech., Inc.*, 175 F.3d 699 (9th Cir.) (magazine article held insufficient to trigger statute of limitations; no discussion of company's knowledge of misstatement), *cert. denied*, 120 S. Ct. 528 (1999); *Shaw v. Digital Equip. Corp.*, 82 F.3d 1194 (1st Cir. 1996) (evidence of actual market knowledge, "while proper grist of the summary judgment mill," held inappropriate for consideration on motion to dismiss); *Sailor v. Northern States Power Co.*, 4 F.3d 610 (8th Cir. 1993) (utility, which had disclosed the existence of its pending request for a rate increase, not

it makes sense to excuse material misstatements only upon a showing by the company that the same information had "credibly entered the market" through other sources and thereby "dissipated the effects of the misstatements." *See Basic*, 485 U.S. at 249.

When the information consists only of unproven allegations of wrongdoing, courts have taken a different approach. Companies are not required to predict the accuracy of such "soft" information. For example, in *In re Sofamor Danek Group, Inc.*, 123 F.3d 394 (6th Cir. 1997), *cert. denied*, 523 U.S. 1106 (1998), shareholders filed a securities fraud action against a manufacturer of medical devices, claiming, *inter alia*, that the company had illegally supported a non-profit foundation and had failed to disclose that it was unlawfully promoting certain of its products for an unapproved use. Like petitioners here, the shareholders in *Sofamor Danek* claimed that the growth in revenues and earnings reported by the company were in fact due in part to its unlawful promotional practices. Like Food Lion here, Sofamor Danek had disclosed all that it knew, *i.e.*, the fact that it had received a "warning letter" from the Food and Drug Administration regarding the alleged unlawful promotional practices. Noting that the shareholders did not challenge the accuracy of the sales and earnings data that the company reported, the court distinguished such "hard" data from "soft" information, such as opinions and predictions. *Id.* at 401. "The legality of Sofamor Danek's support for the non-profit foundation, for example, was a matter of opinion—'soft information.' And 'our cases firmly establish that soft information . . . must be disclosed only if . . . virtually as certain as hard facts.'" *Id.* at 402, quoting *Starkman v.*

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required to speculate about its chances of success); *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509 (7th Cir. 1989) (same).

*Marathon Oil Co.*, 772 F.2d 231, 241 (6th Cir. 1985), *cert. denied*, 475 U.S. 1015 (1986). The court also explained the difficulty that a contrary ruling would create:

> If the company had publicly opined that its support of the non-profit foundation was illegal, and if it had publicly predicted that the FDA would move against the company, the opinion would have come to look increasingly questionable with the passage of time, and the prediction would have proved to be flatly erroneous. This illustrates, we think, why predictions not "substantially certain to hold," like most matters of opinion, simply do not come within the duty of disclosure.

*Id.* at 402.

Food Lion disclosed all that it could disclose when it reported the existence of the allegations; as the district court's finding on the absence of scienter confirms, the information available to Food Lion did not establish that the allegations were true, and Food Lion therefore cannot be faulted for not admitting the existence of widespread violations. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) (cause of action for securities fraud requires evidence of scienter). Indeed, given the subsequent settlement of the claims of widespread violations for an amount that even petitioners' expert admitted was immaterial, any "admission" by Food Lion suggesting that the allegations could result in material liability could have itself been an actionable misstatement. The Fourth Circuit's analysis is fully consistent with the treatment of "soft" information by the courts.

## II. THE COURT WOULD NOT REACH THE ISSUE PRESENTED IF THE WRIT WERE GRANTED

Petitioners' securities fraud claim requires a showing that Food Lion made a statement that was false or misleading as to a material fact. *Basic*, 485 U.S. at 238. The court below found that the general statements of corporate well-being in Food Lion's annual and quarterly reports, *i.e.*, all of the statements listed in petitioners' complaints, were not actionable because they constituted "immaterial puffery," had not been shown to be false, and did not say anything about off-the-clock work. The court went on, however, to address petitioner's contention that additional statements by Food Lion denying the UFCW's claims could be actionable, rejecting them as immaterial because of the information already in the market. Although Food Lion argued that the statements denying the UFCW's claims should not be considered because they had not been challenged in the district court as actionable statements and could not be raised for the first time on appeal,[11] the court did not address that argument in its opinion, presumably because its disposition rendered the argument moot. Petitioners do the same thing here, spending seven pages of their petition discussing

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[11] The requirement that fraud be pled with particularity, Fed. R. Civ. P. 9(b), precluded petitioners from premising their appeal on statements that they had not listed in their complaint and had not raised in the district court to support their claims. *See Hillson Partners Ltd. Partnership v. Adage, Inc.*, 42 F.3d 204, 218 n.12 (4th Cir. 1994); *Moody v. Empire Life Ins. Co.*, 849 F.2d 902, 906 (5th Cir. 1988). The impropriety of petitioners' reliance on statements that were not identified in their complaints is compounded by their attempt here to substitute a "misrepresentation" theory for the "omissions" theory they presented to the district court. *See* n.5, *supra*; App. 106a-107a; 112a-113a n.9.

numerous statements by Food Lion that were not raised in their complaint. Pet. at 9-15.

In order to reach the issued presented by petitioners, it will therefore be necessary for this Court first to decide either that the court of appeals erred in characterizing the general statements in Food Lion's filings with the SEC as "immaterial puffery," or that petitioners can properly premise arguments in the court of appeals and this Court on evidentiary grounds not presented to the district court. The first alternative would require the Court to decide an inherently case-specific issue that even petitioners do not believe to be appropriate for this Court's consideration, having not raised it in their petition. The second alternative would require a finding by this Court that consideration of the issue is justified by the presence of extraordinary circumstances. *See Hormel v. Helvering*, 312 U.S. 552, 56 (1941); *Skipper v. French*, 130 F.3d 603, 610 (4th Cir. 1997); *Muth v. United States*, 1 F.3d 246, 250 (4th Cir. 1993). In neither case is it likely that this Court would ultimately find that it is proper to consider the issue presented.

## III. THE UNDISPUTED EVIDENCE THAT THE CLAIMS OF WIDESPREAD LABOR LAW VIOLATIONS WERE SETTLED FOR AN AMOUNT CONCEDED TO BE IMMATERIAL, AND THE DISTRICT COURT'S RULING THAT PETITIONERS DID NOT ESTABLISH SCIENTER, DISPEL ANY REASON FOR REVIEW

Even if review of the Fourth Circuit's decision was otherwise warranted, the existence of alternative grounds for affirming its ruling renders consideration of petitioners' arguments unnecessary. In particular, the court of appeals' observation that the "much larger" off-the-clock problem alleged by the UFCW had been settled for an amount that

experts on behalf of both Food Lion and petitioners agreed was immaterial in light of Food Lion's earnings provides an independent ground for affirming the result reached below. Although petitioners speculated that the settlement could have had costs in addition to the wage claims reflected in the monetary settlement, they did not support their argument with evidence sufficient to create a genuine issue of fact regarding the materiality of any such costs. Mere speculation about the existence and amount of additional costs is insufficient to defeat summary judgment. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 249-50 (1986).

Similarly, in addition to finding that Food Lion's alleged omissions were immaterial, the district court held that petitioners' evidence was insufficient to establish that Food Lion or Tom Smith had acted with scienter in failing to admit that the allegations of widespread labor law violations were true. Scienter is an essential element of a securities fraud claim under Section 10(b). *Ernst & Ernst v. Hochfelder*, 425 U.S. at 193. Even in the unlikely event that this Court was to find that the Fourth Circuit had somehow erred, there is no reason to think that the district court's finding on scienter would be reversed.

Because review of the Fourth Circuit's decision is unlikely to change the outcome of the case, the petition should be denied.

## CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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